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A PROPOSAL AS TO THE CODIFICATION AND RESTATEMENT OF THE ULTRA VIRES DOCTRINE

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It seems to have become customary to launch a new discussion of the doctrine of ultra vires upon a wave of apology. To apologize by saying that the writer has new ideas to offer would be to display both temerity and ignorance, for which there is no apology. Let it be explained, therefore, that the purpose of these pages is three-fold: *first*, to remind those interested that two organizations now exist which can assist in solving the perplexities of the ultra vires problems; *second*, to present the writer's views as to what these bodies can do and what solution they should adopt; *third*, to urge others to present their views as to what should be done to the end that the opportunities that exist may be availed of and that the solution finally presented may be not only sound but one that meets with general approval.

The organizations whose duty it should be to find a solution of the ultra vires problem, a problem as to which "the authorities are in utter confusion,"¹ "a state of hopeless and inextricable confusion,"² are two, The National Conference of Commissioners on Uniform State Laws and The American Law Institute.

The first tentative draft of an "Act to Make Uniform the Law of Business Corporations" was presented to the Conference in 1909. The ninth tentative draft was considered by the Conference at its session in 1924, and it is likely that a tenth draft will come before the Conference at its next session in

¹ 2 MACHEN, MODERN LAW OF CORPORATIONS (1908) §§ 1021, 1048.

² Thompson, *The Doctrine of Ultra Vires in Relation to Private Corporations* (1894) 28 AM. L. REV. 376.

the summer of 1927. No one of the first eight drafts took the ultra vires doctrine into account. In spite of the periodic revisions of corporation statutes, only one state legislature, that of Vermont, seems to have made a conscious effort to affect the ultra vires problem through legislation.³ If the proposed revision of the Ohio corporation law, now being drafted by a committee of the Ohio State Bar Association, becomes law, another state will have dealt with the ultra vires problem legislatively.

Should the ultra vires doctrine be left entirely to the American Law Institute for a restatement? To what extent is remedial legislation appropriate or desirable? It seems obvious that so far as the ultra vires dilemma is of legislative creation the key to its solution is in the hands of the legislature. A restatement may influence the courts in shaping case law but cannot do more. The courts cannot effect a complete cure without usurping the function of the legislature.⁴ One needs only to be reminded of the *Ashbury* case⁵ and the *Central Transportation Company* case⁶ to recall that the doctrine of limited capacity was the result of a judicial interpretation of legislative intention. In the decision of the lower court in the *Ashbury* case⁷ Lord Blackburn had reasoned that, since at common law a corporation had the capacity of a group of natural persons, that is, a capacity to do an unauthorized or forbidden act,⁸ so a corporation created by legislative act should have the same general capacity to do an unauthorized or forbidden act, unless it were clear from a reading of the statute that the legislature had expressly or impliedly given it only limited capacity. The statute, being in derogation of the common law, should be strictly con-

³ Vt. Gen. Laws (1917) §§ 4919, 4923. These provisions were introduced upon a revision of the General Corporation Law in 1915. Vt. Laws 1915, No. 141, § 15: "*Authority of corporations.* A corporation shall have authority to do any act which is necessary or proper to accomplish its purposes, and which is not repugnant to law. Without limiting or enlarging the effect of this general grant of authority, it is hereby specifically provided that it may have a corporate seal," etc. For an additional portion of this section, see *infra* note 124.

⁴ See 2 MACHEN, *op. cit. supra* note 1, at § 1058.

⁵ *Ashbury Railway Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 653, 673, 677, 684 (1875).

⁶ *Central Transportation Co. v. Pullman's Car Co.*, 139 U. S. 24, 53, 11 Sup. Ct. 478, 486 (1890): "The necessary conclusion from these premises is, that the contract sued on was unlawful and void, because it was beyond the powers conferred upon the plaintiff by the legislature, and because it involved an abandonment by the plaintiff of its duty to the public."

⁷ *Riche v. Ashbury Railway Carriage & Iron Co.*, L. R. 9 Ex. 224, 261-265 (1874).

⁸ For an interesting and helpful application of the Hohfeldian concepts of "privilege" and "power" to the ultra vires problem, see Harno, *Privileges and Powers of a Corporation and the Doctrine of Ultra Vires* (1925) 35 YALE LAW JOURNAL, 13.

strued. Lord Haldane, in the *Bonanza Creek* case,⁹ pointed out that this reasoning of Lord Blackburn was held by the House of Lords in the *Ashbury* case¹⁰ to be erroneous:

"it is wrong, in answering the question what powers the corporation possesses when incorporated exclusively by statute, to start by assuming that the Legislature meant to create a company with a capacity resembling that of a natural person, such as a corporation created by charter would have at common law, and then to ask whether there are words in the statute which take away the incidents of such a corporation. . . . Such a creature, where its entire existence is derived from the statute, will have the incidents which the common law would attach if, but only if, the statute has by its language gone on to attach them. . . . The question is simply one of interpretation of the words used. . . . The language may be such as to show an intention to confer on the corporation the general capacity which the common law ordinarily attaches to corporations created by charter. In such a case a construction like that adopted by Blackburn, J., will be the true one."

How simple, therefore, would it be for the legislature, expressing itself in no uncertain terms, to relegate the remaining vestige of that false conception that the articles of incorporation state "the ambit and extent of vitality and power which by law are given to the corporation,"¹¹ to destroy the very premise of the deduction that "the objection to the [ultra vires] contract is, not merely that the corporation ought not to have made it, but that it could not make it,"¹² and to establish a distinction, which has the virtue of being true, between capacity to act and authority to act, recognizing that the incorporated group, like the individual human being, or an unincorporated group, has the capacity to do an unauthorized or even an illegal act.¹³

The decision in the *Bonanza Creek* case¹⁴ made it clear that

⁹ *Bonanza Creek Gold Mining Co., Ltd. v. Rex* [1916] 1 A. C. 566, 577-578.

¹⁰ *Supra* note 5.

¹¹ *Ashbury Railway Carriage & Iron Co. v. Riche*, *supra* note 5, at 670.

¹² *Central Transportation Co. v. Pullman's Car Co.*, *supra* note 6, at 59, 11 Sup. Ct. at 488.

¹³ This distinction was established by the Vermont statute, *supra* note 3, by substituting "authority" for the usual expression "power." The Hohfeldian nomenclature would be "power" and "privilege" rather than "capacity" and "authority." See Harno, *op. cit. supra* note 8. Comstock, C. J., in *Bissell v. Michigan Southern R. R.*, 22 N. Y. 258, at 266 (1860) says: "In the same sense, natural persons are under the restraints of law, but they may transgress the law, and when they do so they are responsible for their acts. From this consequence corporations are not, in my judgment, wholly exempt. . . . Thus like moral and sentient beings, they may and do act in opposition to the intention of their creator, and they ought to be accountable for such acts." See also Selden, J., at 282.

¹⁴ *Supra* note 9.

Canada had two kinds of corporations, those created by letters-patent which had the general capacity possessed at common law by corporations created by royal charter, and companies incorporated by registering memoranda of association with the consequent limited capacity of legislatively created corporations. Accordingly, many of the Provincial Companies acts were amended so as to extend to all corporations, however formed, "the general capacity which the Common Law ordinarily attaches to Corporations created by Charter."¹⁵

Another prop of the ultra vires structure for the removal of which legislation would seem appropriate, if not necessary, is the rule that all persons dealing with a corporation are held to have notice of the charter limitations on corporate authority. This aspect of the problem is to be considered later.

The American Law Institute has authorized a "Restatement of the Law of Business Associations." The work has been commenced in the field of incorporated associations. It will have to include a restatement of the doctrine of ultra vires, unless it should be concluded that the problem is one that can be solved only through remedial legislation, and that a solution worked through the courts would be effected only by judicial legislation. It is doubtful if such a conclusion will be reached by anyone. The cure of the ultra vires ailment calls for some legislation and much restatement by the courts. The present opportunities should not be lost by the Conference of Commissioners on Uniform State Laws and the American Law Institute. It is submitted that neither can perfect a cure without the co-operation of the other. However, before the surgeon applies the knife or the physician prescribes the remedy, each must diagnose the malady and regard its history.

THE CONDITION OF AMERICAN LAW RELATING TO ULTRA VIRES

One eminent writer has said that "to attempt to unravel the tangle so as to show what rules of law are adopted in each state would be a protracted, if not impossible, task."¹⁶ In spite of

¹⁵ Ont. Stat. 1916, c. 35, § 6. See also Alta. Stat. 1916, c. 26, § 1; Man. Stat. 1917, c. 12, § 1; 1 Sask. Rev. Stat. (1920) c. 76, § 14. For the effect of the Ontario act, see *Edwards v. Blackmore*, 42 Ont. L. Rep. 105, 42 Dom. L. Rep. 280 (1918). See also MASTEN AND FRASER, *COMPANY LAW* (2d ed. 1920) 88-93; Thompson, *The Doctrine of Ultra Vires in Relation to Incorporated Companies in Canada* (1920) 40 CAN. L. T. 993; Thompson, *Are Joint Stock Companies Common Law Corporations* (1922) 42 CAN. L. T. 143, 245, 302; Garrett, *Bonanza Creek Case and Common Law Corporations* (1922) 42 CAN. L. T. 433; Garrett, *Companies and Dominion and Provincial Laws* (1922) 42 CAN. L. T. 466, 478-487; Mulvey, *Common Law Companies* (1925) 10 PROCEEDINGS CAN. BAR ASS'N, 176.

¹⁶ 2 MACHEN, *op. cit. supra* note 1, § 1021.

this condition of apparent confusion, there are certain propositions as to which there is substantial unanimity among courts, and certain propositions which have the support of a majority of the American jurisdictions. A brief resumé of these propositions follows.

Proposition I. Even when a corporation assumes to engage in an ultra vires business, responsibility will attach to the corporation for torts committed by its agents, acting within their authority, in the course of that business. There may be said to be substantial unanimity among the American jurisdictions in support of this proposition.¹⁷ The decisions to the contrary may be explained upon one of two grounds:

First: That a corporation, lacking the capacity to conduct a given business, lacks the capacity to commit a tort as incident to the conduct of that business.¹⁸ Certainly, the view that a corporation lacks the capacity to do an ultra vires act logically compels this result as to torts. On the other hand, is not the fact that the overwhelming weight of American authority imposes responsibility upon the corporation for torts committed ultra vires a cogent repudiation of the lack of capacity doctrine? Even the Supreme Court has said in a non-contract case:

"But the argument is unsound that whatever is done by a corporation in excess of the corporate powers, as defined by its charter, is as though it was not done at all. . . . The truth is, that, with the great increase in corporations in very recent times, and in their extension to nearly all the business transactions of life, it has been found necessary to hold them responsible for acts not strictly within their corporate powers, but done in their corporate name, and by corporation officers who were competent to exercise all the corporate powers. When such acts are not founded on contract, but are arbitrary exercises of power in the nature of torts, or are quasi-criminal, the corporation may be held to a pecuniary responsibility for them to the party injured."¹⁹

¹⁷ For a collection of authorities see 2 MACHEN, *op. cit. supra* note 1, § 1072; 14A C. J. 769; 5 FLETCHER, CYCLOPEDIA OF CORPORATION LAW (1917) § 3339; Hildebrand, *Torts in Ultra Vires Undertakings* (1922) 1 TEX. L. REV. 52.

¹⁸ *Weckler v. First Nat'l Bank*, 42 Md. 581, 595 (1875) (false representations inducing sale of securities).

¹⁹ *Salt Lake City v. Hollister*, 118 U. S. 256, 260, 6 Sup. Ct. 1055, 1058 (1886) (liability of municipal corporation for tax on liquors distilled by it. In *New York, N. H. & H. R. R. v. Schuyler*, 34 N. Y. 30, 49-50 (1865) it is said: "A corporation is liable to the same extent and under the same circumstances as a natural person for the consequences of its wrongful acts, and will be held to respond in a civil action at the suit of an injured party for every grade and description of forcible, malicious or negligent tort or wrong which it commits, however foreign to its nature or beyond its granted powers the wrongful transaction may be." In *New York, L. E. & W. Ry. v. Haring*, 47 N. J. L. 137, 138 (1885) the

Second: Another ground for decisions contrary to Proposition I is that the tort in question was so intimately connected with an ultra vires contract that to permit recovery in a tort action would be to permit an evasion of the rule which denies a right of recovery upon such a contract.²⁰ Resort need not be had to this reasoning in a jurisdiction which insists that a corporation, lacking the capacity to conduct a business, lacks the capacity to commit the tort involved in the conduct of that business. But, conceding that the defense of ultra vires may be interposed in a contract action for reasons other than want of capacity to make the contract,²¹ it is proper to inquire if the same reasons do not justify the interposition of the defense in a tort action arising out of the same transaction. If, for example, in a suit by A against a common carrier upon a contract of carriage made ultra vires, A will be told that he cannot recover because he is charged with notice of the limitations upon corporate authority, then it seems reasonable that A should be met with the same obstacle when he sues the carrier in tort for the negligent performance of the obligation arising out of contract. If, however, we should conclude that it is unreasonable to charge one voluntarily dealing with a corporation with notice of the limitations upon its authority, this basis of distinction between torts which arise out of contract and those which do not, would cease to exist.²² It seems sufficient to say that the overwhelming weight of American authority supports the view that, whatever may be the local rule as to ultra vires contracts, ultra vires is no defense in an action of tort.²³

court says: "It would indeed be an anomalous result in legal science if a corporation should be permitted to set up that inasmuch as a branch of the business prosecuted by it was wrongful, therefore all the special wrongs done to individuals in the course of it were remediless." *Nat'l Bank v. Graham*, 100 U. S. 699, 702 (1879). has this dictum: "Corporations are liable for every wrong they commit, and in such cases the doctrine of *ultra vires* has no application." *Acc: Panama R. R. v. Curran*, 256 Fed. 763 (C. C. A. 5th, 1919).

²⁰ 2 MACHEN, *op. cit. supra* note 1, § 1072. *Gunn v. Central R. R.*, 74 Ga. 509 (1885). *Contra: New York L. E. & W. R. R. v. Haring*, *supra* note 19; *Bissell v. Michigan Southern R. R.*, *supra* note 13.

²¹ *Infra*, pp. 309-34.

²² That one dealing voluntarily with a corporation ought not be automatically charged with notice of the charter limitations on corporate powers, see *infra*, pp. 321-28.

²³ *Supra* note 17. Two suggestions as to methods of reconciling the rule of corporate responsibility for ultra vires torts with the rules applying to ultra vires contracts have been made. First, the damage resulting from the tortious act is an existing fact, and the corporation's responsibility is to be governed by the principle applicable to ultra vires contracts which have been executed on one side. *Zinc Carbonate Co. v. First Nat'l Bank*, 103 Wis. 125, 79 N. W. 229 (1899). Secondly, we are to look to the legislative intention in limiting corporate au-

In support of Proposition I as formulated are those decisions which hold that a corporation is not responsible when the tort in question was committed by an agent who was at the time acting outside the scope of the authority conferred upon him by the corporation.²⁴ Can one quarrel with decisions which exonerate a corporation from responsibility upon the basis of this reasoning? If the act, resulting in injury to a third party, is one not within the authority conferred upon the actor by the corporation, then we need not go further and inquire whether the act is one that the corporation lacked capacity to do, and, therefore, could not authorize or ratify. But it is submitted that even if the act is *ultra vires*, that will not prevent the corporation from becoming responsible for the consequences of that act, provided it was done with the authority or ratification of the corporation. Under such circumstances, it is as true to say that

thority, and "it is impossible to suppose that the Legislature intended those companies who were wrongfully (i. e., *ultra vires*) working steamers to be in a better position than those who were rightfully working them; and the Act should not be so construed if the words permit of any other construction." Lord Blackburn in *Doolan v. Midland Ry.*, L. R. 2 A. C. 792, 806 (1877). See also *Oregonian Ry. v. Oregon Ry.*, 22 Fed. 245 (1884) where the legal disability of the corporation, "as in the case of a minor, is a defense personal to the party who is under it, and cannot be taken advantage of by another." This case is approved in BIGGLOW, CSTOPPEL (6th ed. 1913) 501.

²⁴ "In other words, the only application of the doctrine of *ultra vires* to liability of corporations *ex delicto* is in showing that the alleged tortious act was not committed within the scope of authority of the officer or agent who was at fault." 2 MACHEN, *op. cit. supra* note 1, at § 1072. ". . . a corporation is liable for the torts of its agents, to the same extent as an individual under similar circumstances; and . . . the fact that a corporation was not authorized by its charter to commit a tort is no defense in an action by the party injured." 2 MORAWETZ, PRIVATE CORPORATIONS (2d ed. 1886) § 730.

Searle v. First Nat'l Bank, 2 Walk. 395 (Pa. 1885) held that though the act was *ultra vires*, the plaintiff was entitled to go to the jury on the question of whether the cashier's act was ratified by the corporate officers. The jury found no ratification. The cases are very numerous in accord. See *New York, L. E. & W. R. R. v. Haring*, *supra* note 19; *New York, N. H. & H. R. R. v. Schuyler*, *supra* note 19; *Start v. Nat'l Newspaper Ass'n*, 222 S. W. 870 (Mo. 1920).

In *Basil v. Spratt*, 44 Ont. L. Rep. 155, 45 Dom. L. Rep. 551 (1918) the court said it would be willing to adopt the American doctrine of corporate liability for *ultra vires* torts, but in this case finds no evidence of authority conferred upon the agent to act on behalf of the corporation. In *Union Colliery Co. v. Queen*, 31 Can. Sup. Ct. 81 (1900) there is a dictum that a corporation should be held criminally responsible for a crime committed in the course of an *ultra vires* undertaking. Cf. *Banbury v. Bank* [1919] A. C. 626 and *Stevens v. Merchants Bank*, 30 Man. Rep. 46 (1919) and the attack upon these decisions by Thompson, *Frauds of the Law* (1920) 40 CAN. L. T. 361. See also *Whaley v. O'Grady*, 22 Man. Rep. 379, 4 Dom. L. Rep. 485 (1912).

the corporation has done the act, though an unpermitted (*i. e.* ultra vires) act, as it is to say that a natural person has committed a tort or crime when he is held to responsibility for the authorized, but tortious or illegal, act of his agent. The Hohfeldians would say that the corporation, like the individual, has the power, though not the privilege, of bringing itself into new legal relations with another.²⁵

In conclusion, then, Proposition I might be stated in this alternative form: A corporation may not, in order to escape responsibility for the tortious acts of its agents, show that they were done in connection with a transaction beyond the scope of corporate authority, but may show that such acts were done in connection with a transaction beyond the scope of the authority conferred by the corporation upon its agent.²⁶ The question how and when authority may be found to have been conferred by the corporation upon the agent, or ratification of his acts given, is postponed for subsequent discussion.²⁷

Proposition II. Even though a corporation has acted outside the scope of its authority in taking or holding title to property, the validity of its title cannot be questioned on the ground that the corporation was without authority, or exceeded its authority, in taking or holding the property. The American authorities are unanimous in support of this proposition.²⁸ It is obviously irreconcilable with the theory of limited capacity to hold that it has acquired a title which it could not acquire. The proposition as stated is intended to be broad enough to preclude an attack upon the title (a) by the state, (b) by either party to a grant to or by the corporation, and (c) by a stranger to the transaction by which the corporation acquired or disposed of the property. There are a few states which have mortmain statutes permitting the state to compel a forfeiture of land held by a corporation without authority.²⁹ In such states, however, it is held that though the title is subject to forfeiture by the state, the corporation's title is to be considered valid until forfeiture

²⁵ Harno, *op. cit. supra* note 8, at 18.

²⁶ BRICE, *ULTRA VIRES* (3d ed. 1893) 439, states that the American cases have established the rule that "if a corporation or its managing body *bona fide* believing that a particular transaction is within its powers direct an act which turns out ultra vires, still the corporation is liable to any person thereby damaged."

²⁷ The meaning of "corporate act," and the application of the principles of the law of Agency in determining when an act is a corporate act are considered at length later, *infra* pp. 329-34.

²⁸ 14A C. J. 319; 3 FLETCHER, *op. cit. supra* note 17, at § 1561; Warren, *Executed Ultra Vires Transactions* (1910) 23 HARV. L. REV. 495; Parks, *Ultra Vires Transactions* (1923) 24 MO. L. BULL. (No. 8) 3, 15.

²⁹ Iowa Code 1924, §§ 10214, 10216, 10218 (corporations organized under laws of a foreign country or domestic corporations more than one-third of whose shares are owned by non-resident aliens), Ky. Stat. (Carroll's

and the state's right to forfeit will be lost if the corporation conveys the property before confiscation proceedings are commenced.³⁰ In the great majority of states, where the unauthorized taking or holding of land is treated like any other ultra vires act, the state's remedy is to institute a *quo warranto* proceeding which may result in a forfeiture of the charter, or in an order that unless the corporation dispose of the property, the charter will be forfeited.³¹ This doctrine that if a corporation takes property for a purpose not authorized by its charter, it thereby opens itself to an attack by the state in a proceeding to forfeit the charter but that the validity of its title is subject neither to a direct nor a collateral attack "has the salutary effect of assuring the security of titles and of avoiding the injurious consequences which would otherwise result."³²

Proposition III. Even though a corporation has acted outside the scope of its authority in making a contract, if the contract has been fully performed on both sides, it will stand as a foundation of rights acquired under it. The American authorities are substantially unanimous in support of this proposition,³³ but the

6th ed. 1922) Const. § 192, Stat. § 567; Minn. Gen. Stat. (1922) §§ 8077-8080; 2 Miss. Ann. Code (Hemingway, 1917) § 4075 (forfeit charter and land held in excess of limit); Neb. Comp. Stat. (1922) §§ 5687-S (corporations other than those organized under the laws of Nebraska, and Nebraska corporations a majority of whose board of directors are aliens); 1 N. D. Comp. Laws Ann. (1913) §§ 4503-4 (religious and charitable corporations); 1 Okla. Comp. Stat. (1921) Const. art. XXII, § 2, 2 *ibid.* § 11321; Pa. Stat. (West, 1920) §§ 10233-10248, 2 Pa. Digest (Purdon's 13th ed. 1907) 1476, 8 *ibid.* (Supp. 1921) 8287; Vt. Gen. Laws (1917) § 4922 (religious and charitable corporations). See also 3 FLETCHER, *op. cit.* *supra* note 17, at § 1566.

³⁰ State v. Benevolent Investment and Relief Ass'n, 107 Okla. 228, 232 Pac. 35 (1925) noted in (1925) 10 CORN L. Q. 501.

³¹ See authorities collected in 3 FLETCHER, *op. cit.* *supra* note 17, at § 1524 and 5 *ibid.* § 3270. In a *quo warranto* proceeding, it may be proper to subject the corporation to a money judgment by way of fine or damages for breach of its contract with the state. Standard Oil Co. v. Missouri, 224 U. S. 270, 32 Sup. Ct. 406 (1912). Courts may exercise their discretion in deciding whether a corporation ought to be dissolved for doing unauthorized acts, whether it should be ousted from its charter unless it refrain from ultra vires action, or ousted only from the authority wrongfully assumed. 2 MORAWETZ, *op. cit.* *supra* note 24, at § 1023; 3 COOK, CORPORATIONS (8th ed. 1923) § 633; 14A C. J. 1094. For an argument against the propriety of proceedings on the part of the state to forfeit a charter for ultra vires acts, see Lilienthal, *Non-Public Corporations and Ultra Vires* (1898) 11 HARV. L. REV. 387.

³² Kerfoot v. Farmers' & Merchants' Bank, 218 U. S. 281, 287, 31 Sup. Ct. 14, 15 (1910); 2 MORAWETZ, *op. cit.* *supra* note 24, at § 678.

³³ See authorities collected in 3 FLETCHER, *op. cit.* *supra* note 17, at § 1559; 14A C. J. 319; 2 MACHEN, *op. cit.* *supra* note 1, at §§ 1048-54; Warren, *op. cit.* *supra* note 28; Parks, *op. cit.* *supra* note 28; City of Williston v. Ludowese, 203 N. W. 82 (N. D. 1926). "If such a contract has been completely executed on both sides, the courts will ordinarily re-

processes of reasoning by which the result is reached are varying and conflicting.

Propositions II and III are sometimes merged as one, the acquisition of property being treated as one instance of a contract fully executed. Obviously, however, the unauthorized acquisition of property may have resulted otherwise than by contract, or the contract which has been fully performed may not have been one for the purchase of property. Complications arise in applying the rule enunciated in Proposition III owing to the difficulty of determining whether a given transaction, *e. g.*, a lease,³⁴ a mortgage,³⁵ the acquisition of shares of another corporation,³⁶ or the purchase of a note³⁷ is executed or executory.

Proposition IV. *When a corporation has acted outside the scope of its authority in making a contract, either the corporation or the other party thereto may set that fact up as a complete defense to any action brought either at law or in equity upon the contract, provided the contract is wholly executory on both sides.* The unanimity of the American courts in support of this proposition is broken only by the statement of the Kansas court: "that only the state can challenge the validity of acts done under color of a corporate charter, [which] if accepted, must necessarily protect an executory contract from collateral attack, equally with one that has been executed. The court is convinced of the soundness of the view that in the absence of special circumstances affecting the matter neither party to even an executory contract should be allowed to defeat its enforcement by the plea of *ultra vires*." ³⁸

fuse any relief to either. The usurpation is at an end. Each party has received from the other what he bargained for. Neither of them has any cause to complain. The contract has ceased to be a living thing. The courts will leave it in its grave," *Alabama Cons. Coal Co. v. Baltimore Trust Co.*, 197 Fed. 347, 358 (D. Md. 1912).

³⁴ For a collection of authorities and a discussion of positions taken by the Supreme Court, see 3 FLETCHER, *op. cit. supra* note 17, at §§ 1551, 1587.

³⁵ Cases collected in 3 FLETCHER, *op. cit. supra* note 17, at §§ 1571, 1575.

³⁶ A corporation, purchasing shares *ultra vires*, gets a good title which it can sell. *Bigbee & W. R. Packet Co. v. Moore*, 121 Ala. 379, 25 So. 602 (1899) and dictum in *Holmes & Griggs Mfg. Co. v. Holmes & Wessell Co.*, 127 N. Y. 252, 27 N. E. 831 (1891). But a corporation, purchasing shares *ultra vires*, is not responsible as a shareholder. *California Bank v. Kennedy*, 167 U. S. 362, 17 Sup. Ct. 831 (1897).

³⁷ The maker of a note can not object that a corporate holder purchased the note *ultra vires*. *Prescott Nat'l Bank v. Butler*, 157 Mass. 548, 32 N. E. 909 (1893). Neither can the obligor of a non-negotiable chose in action defend on the ground that the plaintiff corporation's purchase was *ultra vires*. *John Farwell Co. v. Wolf*, 96 Wis. 10, 70 N. W. 289 (1897). *Contra: Pueblo v. Shutt Co.*, 28 Colo. 524, 67 Pac. 162 (1901).

³⁸ *Harris v. Independence Gas Co.*, 76 Kan. 750, 763, 92 Pac. 1123, 1127 (1907). "There is somewhat new and growing doctrine, that whether a corporation has acted in excess of its granted powers, or in face of an

Proposition V. A non-assenting shareholder, unless estopped or barred by his laches, may be granted an injunction to restrain an act threatened to be done on behalf of a corporation when such act would be beyond the scope of corporate authority. "The very basis of the contract of membership in a corporation is that its funds shall be devoted only to the purposes of its business, and any diversion of them to any other or different purpose may always be enjoined by every shareholder."³⁹ It would seem that the state might also be permitted to secure an injunction against threatened ultra vires action in breach of its contract with the incorporators, but the authorities are divided upon the question, strong support being given to the view that the state's remedy is by a *quo warranto* proceeding and not by injunction.⁴⁰ Forestalling threatened ultra vires action is preferable to a forfeiture of the charter for past ultra vires action, and in practice the state's remedy by *quo warranto* is sometimes made to serve injunctively.⁴¹

*Proposition VI. The commission by a corporation of an act outside the scope of the authority conferred upon it does not, of itself, put an end to corporate existence, but furnishes a ground for the forfeiture of the charter of the corporation, or for ousting it from the exercise of the unauthorized powers, upon the state's application in a quo warranto proceeding.*⁴²

Thus through that haze of "hopeless confusion" we are able to discern and reproduce in outline at least six propositions which the American authorities support with substantial unanimity. Eliminating these, the field of conflict is seen to be

expressed or implied statutory prohibition, is one which cannot be raised in litigation between it and a private party, but can only be raised by the State," *City Coal & Ice Co. v. Union Trust Co.*, 140 Va. 600, 607-S, 125 S. E. 697, 699 (1924). Warren, *Executory Ultra Vires Transactions* (1911) 24 HARV. L. REV. 534; Parks, *op. cit. supra* note 28, at 7.

³⁹ 2 MACHEN, *op. cit. supra* note 1, at § 1153.

⁴⁰ The state cannot obtain an injunction: *Att'y Gen. v. Utica Ins. Co.*, 2 Johns. Ch. 371 (N. Y. 1817); *Att'y Gen. v. Tudor Ice Co.*, 101 Mass. 239 (1870); 3 COOK, *op. cit. supra* note 31, at § 635; 3. FLETCHER, *op. cit. supra* note 17, at § 1524. An injunction at the suit of the state is proper: *Trust Co. v. State*, 109 Ga. 736, 35 S. E. 323 (1900); *Columbian Athletic Club v. State*, 149 Ind. 98, 40 N. E. 914 (1895); *State v. Minnesota Thresher Co.*, 40 Minn. 213, 41 N. W. 1020 (1889) dictum; *Madison v. Madison Gas Co.*, 129 Wis. 249, 108 N. W. 65 (1906); 7 R. C. L. 612. Jurisdiction to enjoin at the suit of the state may be conferred upon equity courts, *c. g.*, *Sherman Anti-trust Act*, 26 Stat. 209, (1899) U. S. Comp. Stat. (1916) § 8823; see also *People v. Ballard*, 134 N. Y. 269, 279, 32 N. E. 51, 56 (1892) where it is said, "the proceedings at law by *quo warranto* or *scire facias* are so dilatory that much mischief will generally be done before judgment can be obtained, and are so expensive that a summary remedy seems absolutely necessary."

⁴¹ *Supra* note 31.

⁴² *Supra* notes 31, 40 and 41.

limited to disputes arising out of ultra vires contracts which are neither wholly executory nor wholly executed. The cases falling within this field are of two types: (1) contracts which have been fully performed on one side; (2) contracts which have been but partially performed on one or both sides.

As is well known, there is a distinct line of cleavage which divides the decisions of cases in this field into two general groups:

1. The first group is founded on the reasoning that the ultra vires acts of a corporation cannot result in a contract; that, therefore, if the corporation and the party dealing with it have performed acts upon the footing of a non-existent contract, no action will lie as for breach, or specific performance of a contract, but the facts may present the basis for a quasi-contractual recovery of the value of the benefits conferred by such performance.

2. The second group results from the contrary premise that the legal consequences of a contract may be predicated upon the acts of a corporation though ultra vires, and that if such contract has been performed by one of the parties, or partially by both of the parties, that contract will stand as the basis of an action, either at law or in equity, to secure damages or compel performance to the extent of the plaintiff's performance.

The jurisdictions are by no means evenly divided between these two groups. In the first are the federal courts and the courts of the states of Alabama, Illinois, Maine, Maryland, Massachusetts, Nebraska, New Hampshire and Tennessee.⁴³ The balance of the state courts fall into the second group. This alignment

⁴³ *United States*: Central Transportation Co. v. Pullman's Car Co., *supra* note 6. *Alabama*: Chevacla Lime-Works v. Dismukes, Frierson & Co., 87 Ala. 344, 6 So. 122 (1888); Wiley Fertilizer Co. v. Carroll, 202 Ala. 335, 80 So. 417 (1918). *Illinois*: National Home Ass'n v. Home Savings Bank, 181 Ill. 35, 54 N. E. 619 (1899); Mercantile Trust Co. v. Kastor, 273 Ill. 332, 112 N. E. 988 (1916). *Maine*: Brunswick Gas Light Co. v. United Gas Co., 85 Me. 532, 27 Atl. 525 (1893). *Maryland*: Western Maryland R. R. v. Blue Ridge Co., 102 Md. 307, 62 Atl. 351 (1905). *Massachusetts*: Davis v. Old Colony R. R., 131 Mass. 258 (1881); Williams v. Johnson, 208 Mass. 544, 95 N. E. 90 (1911); Nowell v. Equitable Trust Co., 249 Mass. 585, 144 N. E. 749 (1924) (language used in the opinion is ambiguous and it is suggested that the defense of ultra vires must be retained as to trust companies, whatever the rule may be as to general business corporations). *Nebraska*: Simmons v. Farmers' Union Co-op. Ass'n, 208 N. W. 144 (Neb. 1926) (the opinion contains ambiguous statements). *New Hampshire*: Downing v. Mt. Washington Co., 40 N. H. 230 (1860); Norton v. Derry Nat'l Bank, 61 N. H. 589 (1882). *Tennessee*: Marble Co. v. Harvey, 92 Tenn. 115, 20 S. W. 427 (1892); Leonhardt v. Small, 117 Tenn. 153, 96 S. W. 1051 (1906). *Vermont*: The similar rule formerly obtaining in that state because of Metropolitan Stock Exchange v. Nat'l Bank, 76 Vt. 303, 57 Atl. 101 (1903) has been changed by the statutory provisions quoted *supra* note 3 and *infra* note 124.

is of the utmost significance. It shows not only that the majority of all American jurisdictions fall into the second group, but also that better than eighty per cent of the *state* courts have chosen company in the second group. Assuming for the moment that reason and practical experience give equal support to each of the views, then, it is submitted: (1) a restatement of the law of ultra vires, intended to influence judicial decision, should give due regard to this judicial vote between the two views; (2) a uniform corporation act, prepared for adoption by *state* legislatures, and aimed at bringing uniformity rather than reformation in state law, should reflect the views of eighty per cent of the states rather than the views of twenty per cent of them. Incidentally, it is to be observed that, to the extent that the ultra vires doctrine is dependent upon statutory construction, a revision of state legislation will be corrective of federal decisions involving the acts done on behalf of a corporation organized under state legislation.

The choice between two irreconcilable results should not be made solely upon a consideration of the proportions of the present judicial vote between them, if reason and practical experience seem to command us to side with the minority. Where lies the better reason and what is the lesson of experience? Let us briefly examine and consider the grounds advanced as justifying a collateral attack upon the authority of a corporation to engage in a particular transaction, and consider how they should be disposed of in framing a restatement and in drafting corrective legislation.⁴⁴

1. *Is unauthorized corporate action illegal?*

Whether ultra vires action is illegal depends upon how "ultra vires" is defined. "In its proper sense, it denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined by the statute under which it is formed or which are applicable to it, or by its charter or incorporation paper." This definition of "ultra vires" found in Machen's notable work on Corporations⁴⁵ has also been adopted in Halsbury's Laws of England.⁴⁶ Substituting the word "authority" for "legitimate powers," the definition certainly accords with the general understanding of the expression "ultra vires." By its very terms, it excludes the quality of illegality from the act in question, and makes the want of authority to do the act the sole

⁴⁴ The analysis here followed is that adopted by Prof. C. E. Carpenter in his article *Should the Doctrine of Ultra Vires Be Discarded* (1923) 33 YALE LAW JOURNAL, 49, 57.

⁴⁵ 2 MACHEN, *op. cit.* *supra* note 1, at § 1012.

⁴⁶ 5 HALSBURY'S LAWS OF ENGLAND (1910) 285.

objection to it. In the *Ashbury* case,⁴⁷ Lord Cairns said, "I have used the expressions *extra vires* and *intra vires*. I prefer either expression very much to one which occasionally has been used . . . in other cases, the expression 'illegality.' . . . In a case such as that which your Lordships have now to deal with, it is not a question whether the contract sued upon involves that which is *malum prohibitum* or *malum in se*, or is a contract contrary to public policy, and illegal in itself. . . . The question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract."

Where an act on the part of a corporation would be illegal or contrary to public policy if done by an individual, or is an act which a corporation is expressly prohibited from doing, then the consequences resulting from such illegal action should not be, and are not, different from those resulting from similar acts done by an individual. The rule that the law will not help either party to an illegal contract, that it will give neither enforcement of, nor relief from such a contract, is demanded by public policy as a method of discouraging and indirectly preventing illegal conduct. "To deny such persons damages, though an equally guilty defendant thereby escapes punishment will tend to diminish the number of illegal agreements."⁴⁸ But to deny an innocent plaintiff affirmative relief when he has partially performed the illegal contract, and to permit the defendant to retain the fruits of his illegality will tend to augment the number of such agreements. Therefore, the courts will sometimes give affirmative relief to a party to an illegal contract when they find that the giving of such relief will serve the public interests. The party to whom the relief is given is

⁴⁷ *Supra* note 5, at 672. "But the words *illegal* and *void* are elusive; it is feared that they are frequently used like curse words to fill in where other language fails," Harno, *op. cit. supra* note 8, at 24. "The word 'unlawful' as applied to contracts may mean either that it is unlawful in that the corporation has not the power to make it conferred by its charter, or it may mean that it is prohibited by the constitution or laws of the state, or public policy or the common law. It may be said that the courts of Kentucky have not held that the mere want of a grant of power to make a contract by a corporation rendered the contract void, but upon the contrary have adjudged rights based upon such contracts and permitted them to be used as defenses and applied the doctrine of estoppel to them." *Hind v. Cook Co.*, 202 Ky. 526, 532, 260 S. W. 349, 351 (1924). In that case it was found that the corporation had insured property in violation of an express provision that no property should be insured which was outside the limits of the territory specified in the certificate of incorporation. The application to ultra vires contracts of the rule that illegal contracts cannot be enforced is comparatively modern. *Tracy v. Talmage*, 14 N. Y. 162, 179 (1856).

⁴⁸ 3 WILLISTON, CONTRACTS (1920) § 1630.

the instrument through whom the public is served.⁴⁹ That party must be innocent of wrongdoing. To deny him relief, it is not enough that he is *particeps criminis*, he must be also *in pari delicto*. Even if persons dealing with a corporation are presumed to know the extent of corporate powers, "yet this is by no means a safe rule by which to measure the moral delinquency of the respective parties."⁵⁰

The above reasoning would be sufficient to support the granting of affirmative relief to one who has innocently entered into a contract which is ultra vires the defendant corporation. But when we find that the federal courts permit the corporation to recover in quasi-contract the value of the benefits conferred upon the third party under the ultra vires contract, and that the eighty per cent of the American jurisdictions which permit the third party to recover in an action upon the partially executed ultra vires contract also permit the corporation itself to recover upon the contract, it must be concluded that the action in excess of corporate authority is not so contrary to public policy as to be visited with the consequences of illegal action. Ultra vires action is not, therefore, illegal.⁵¹ Is it against public policy?

2. *Is unauthorized corporate action against public policy?*

Of course, it is against public policy for a corporation to usurp authority that has not been conferred upon it. This objection, however, has less force when applied to private business corporations than when applied to municipal corporations, and it is important to note that its application originated with reference to the acts of municipal corporations and was then transferred to the acts of private business corporations without any special reference to the interests of the public.⁵² Even if the ultra vires action of private business corporations is against public policy, still we have just seen that the law does not say that because a contract is illegal, therefore, an action may not be maintained upon it. So the law should not say that because a contract is ultra vires, therefore, it cannot be the foundation of enforceable rights. As in the field of illegal contracts, so in the field of ultra vires contracts, the real problem is to find the solution which will discourage offenses of usurping authority without working injustice. An indiscriminate sanction of the plea of ultra vires might be subversive of justice due the plaintiff, and, by immunizing the defendant from civil responsibility, might encourage ultra vires conduct by reducing the risks at-

⁴⁹ 13 C. J. 497 *et seq.*

⁵⁰ Tracy v. Talmage, *supra* note 47, at 138.

⁵¹ See the argument against illegality of ultra vires action in Carpenter, *op. cit. supra* note 44, at 59.

⁵² City Coal & Ice Co. v. Union Trust Co., *supra* note 38, at 505, 125 S. E. at 698; 2 COOK, *op. cit. supra* note 31, at § 631.

tendant upon such action. It matters not whether the corporation or the third party is the defendant in such a suit. "Public policy is promoted by the discouragement of fraud and the maintenance of the obligation of contracts, and to permit a lessee of a corporation to escape the payment of rent by pleading the incapacity of the corporation to make the lease, although he has had the undisturbed enjoyment of the property, would be, we think, most inequitable and unjust," said the New York Court of Appeals in *Bath Gas Light Co. v. Claffy*.⁵³

Even the Supreme Court, which, when dealing with *ultra vires* contracts, usually carries the doctrine of lack of capacity to its ultimate conclusion, has said: "The doctrine of *ultra vires*, whether invoked for or against a corporation, is not favored in the law. It should never be applied where it will defeat the ends of justice, if such a result can be avoided."⁵⁴ Similarly, although the English authorities sanction the plea of *ultra vires* in contract actions, yet in 1852, Lord St. Leonards was of the opinion that, "nothing can be more indecent than for a great company like this to allege, by way of defense, that a solemn contract which they have entered into is void on the ground of its not being within their powers, not from any mistake, misapprehension, or subsequent accident, but because they thought fit to enter into it, and meant to have the benefit of it, if it turned out for their benefit, and to take advantage of the illegality in case the contract should prove onerous, and they should desire to get rid of it."⁵⁵ Upon the appeal of the same case before the House of Lords, Lord St. Leonards again expressed his belief that "the safety of men in their daily contracts requires that this doctrine of *ultra vires* should be confined within narrow bounds."⁵⁶

An analogous problem had to be solved by the courts in dealing with *de facto* corporations. In *Boyce v. Towsonton Station*,⁵⁷ the Maryland court, deciding that the individual defendants could not be estopped from denying that they were a corporation, reasons thus: "Whilst denying its capacity upon any principle of

⁵³ 151 N. Y. 24, 36, 45 N. E. 390, 393 (1896). The application of the *ultra vires* doctrine was "found by experience in many cases to violate that highest public policy, 'that corporations ought not to be upheld in dishonesty any more than individuals; and that it is contrary to the highest public policy for the judicial courts to sustain a corporation in dishonesty by assisting it in repudiating its honest contracts,'" *City Coal & Ice Co. v. Union Trust Co.*, *supra* note 38, at 606, 125 S. E. at 698.

⁵⁴ *San Antonio v. Mehaffy*, 96 U. S. 312, 315 (1877); *Railway v. McCarthy*, 96 U. S. 258 (1877). See also *St. Avit v. Kettle River Co.*, 216 Fed. 872 (C. C. A. 8th, 1914).

⁵⁵ *Hawkes v. Eastern Counties Ry.*, 1 De G. M. & G. 737, 760 (1852).

⁵⁶ *Eastern Counties Ry v. Hawkes*, 5 H. L. Cas. 331, 371 (1855).

⁵⁷ 46 Md. 359, 373 (1876).

estoppel, to make contracts *ultra vires*, to bind itself; it would not be consistent with that theory to recognize its *existence ad libitum*, according to the conduct of the parties concerned." If the incorporated associates cannot act as a unit outside the limits of authorized corporate action, then surely associates who assume to be incorporated, but are not, cannot act as a legal unit.⁵⁸ But that decision in Maryland was counteracted by statute,⁵⁹ and in at least fifteen other states there are similar statutes substantially to the effect that where individuals have attempted to form a corporation formable under a statute of the state, and have assumed to act as a corporate unit, the state alone can inquire into their right to act as a unit.⁶⁰ The same result has been reached by judicial decision in the federal courts and in the overwhelming majority of state courts.⁶¹ By statutory provision, it has also become the accepted principle of the law of England and that of many of the English colonies and dominions.⁶²

It is submitted that the logic in the Maryland court's reasoning was sound. If corporate effect will not be given to the acts of associates acting outside the scope of corporate authority, then corporate effect ought not to be given to the acts of associates who are not incorporated. The policy and reason which demand the one result demand the other. In fact, the usurpation of corporate existence by individuals seems a more serious offense than the usurpation of corporate authority by an existing corporation. The Maryland court in the same case says:

"It would be more reasonable to hold corporations to their contracts, though *ultra vires*, of which they have received the benefit,

⁵⁸ In *Bergeron v. Hobbs*, 96 Wis. 641, 646, 71 N. W. 1056, 1057 (1897) Marshall, J., employed the converse reasoning that since no collateral attack is permitted in an action upon an *ultra vires* contract, therefore, collateral attack should not be permitted to test the *de facto* existence of a corporation.

⁵⁹ Md. Laws 1908, art XXIII, c. 240, § 6.

⁶⁰ Ariz. Rev. Stat. (1913) § 2113; Calif. Cyc. Code (Kerr's 2d ed. 1920) § 358; 2 Fla. Rev. Gen. Stat. (1920) §§ 4053, 4115; 2 Ga. Ann. Code (Park, 1914) § 2226; Iowa Code (1920) § 8401; Ky. Stat. (Carroll's 6th ed. 1922) § 566; 1 La. Ann. Rev. Stat. (Marr, 1915) § 1428; La. Laws 1914, Act 267, § 12; Nev. Rev. Laws (1912) § 1154; 1 N. D. Comp. Laws Ann. (1913) § 4496; 2 Okla. Comp. Stat. Ann. (1921) § 5293; Or. Laws (Olsen, 1920) § 6858; 3 S. C. Code (1922) § 4306; 1 S. D. Rev. Code (1919) § 239; Tenn. Shannon's Code (Thompson, 1917) §§ 2026, 2031, 2064; Vt. Gen. Laws (1917) § 4900.

⁶¹ Warren, *Collateral Attack on Incorporation* (1906) 20 HARV. L. REV. 456; (1907) 21 *ibid.* 305; Carpenter, *De Facto Corporations* (1912) 25 *ibid.* 623; 7 R. C. L. 60 *et seq.*; *Kardo v. Adams*, 231 Fed. 950 (C. C. A. 6th, 1916) reversing 222 Fed. 967 (N. D. Ohio, 1915).

⁶² Companies (Consolidation) Act (1908) 8 Edw. VII, c. 69, § 17; Dominion Companies Act, (1906) 2 Rev. Stat. Can., c. 79, §§ 4, 111; see MASTEN & FRASER, *op. cit. supra* note 15, at 11; New Zealand Consol. Stat. (1908) No. 26, § 26 (3), (4).

or to prevent parties who have contracted with them, and received the benefit therefrom, from defeating their liability, on the ground of want of power in the corporation, . . . than to hold that corporations should be deemed to have existence, because they had so held themselves out."⁶³

Applying the same logical method of reasoning employed by the Maryland court, will it not have to be conceded that if the law does now permit unincorporated individuals, under certain extenuating circumstances, to act as if they were a legal unit, then it is even more reasonable, under similarly extenuating circumstances, to give legal effect to the acts of a corporation, even when such acts are outside the scope of authorized corporate action?

In dealing with *de facto* corporations, the extenuating circumstances are: (1) a statute under which the kind of corporation attempted to be formed might have been formed *de jure*; (2) a real though insufficient attempt to comply with the statute; (3) acts done by the associates as a corporation.⁶⁴ Two public interests are then found contending for supremacy. The one is opposed to an unauthorized assumption of corporate existence. The other is in favor of giving a general assurance of security in business dealings. In private litigation, the latter preponderates over the former. The former is adequately guarded by the power of the state to intervene. "Until such interposition [by the sovereign] the public may treat those possessing and exercising corporate powers under color of law as doing so rightfully. The rule is in the interest of the public, and is essential to the safety of business transactions with corporations."⁶⁵

When A and corporation X have made a contract, the making of which was beyond the scope of X's authority, the same two public interests fight a battle royal in the judge's mind. The one says: "You must prevent these assaults upon the state's prerogative and frown upon X's irregular arrogation of authority" ; the other says: "You must not permit the plea of *ultra vires* to jeopardize the public sense of security in dealing with a corporation, nor allow the plea to be used by either A or X to work an injustice to the other." To guard the first of these public interests, shareholders are permitted to enjoin threatened *ultra vires* action, the state can proceed directly against the corporation whenever any act has been done *ultra vires*, a wholly executed *ultra vires* transaction will not be undone by the courts,

⁶³ *Supra* note 57, at 373.

⁶⁴ *Snider's Sons v. Troy*, 91 Ala. 224, 8 So. 658 (1890); *Duggan v. Colorado Co.*, 11 Colo. 113, 17 Pac. 105 (1887); *Society Perun v. Cleveland*, 43 Ohio St. 481, 3 N. E. 357 (1885). See also *supra* note 61.

⁶⁵ *Duggan v. Colorado Co.*, *supra* note 64, at 115, 17 Pac. 105. For the distinction between "privilege" and "power" as assisting in explaining the *de facto* doctrine, see *Harno, op. cit. supra* note 8, at 19.

and, according to the existing authorities, a wholly executory contract will not be enforced by them. Does the protection of this public interest also require that the defendant in an action upon a partially executed ultra vires contract shall be permitted to plead the want of corporate authority to make the contract? Are there not extenuating circumstances when we find (a) that the contract is not one that is either illegal or prohibited, but one simply that X lacked authority to make, and (b) that the contract, though unauthorized, has been performed by one of the parties or partially performed by both of them? If the plea of ultra vires is then allowed to prevail, will it tend to serve the public by discouraging ultra vires action? Will it not rather defeat justice?

Here, it is submitted, is the only rational foundation for the variation in decisions with regard to ultra vires contracts, varying as the particular contract is one that has been fully executed, partially executed, or wholly executed. In the judicial laboratory, the two public interests are commingled as reagents and the decision precipitated is determined by the force of the attendant elements peculiar to the particular case.

3. *Is the defense of ultra vires required for the protection of corporate creditors?*

It must be first understood that the class to be protected is made up of those who have become creditors as the result of intra vires transactions, and also that the defense would be permitted for their protection only in actions upon contracts which are either wholly or partially executory. The theory of the intra vires creditor's right would be that he has contracted with the corporation relying upon the fact that its assets will not be risked in ultra vires ventures. There seems to be very little judicial support for this contention,⁶⁶ and no case has been found where a corporate creditor has been permitted to enjoin threatened ultra vires action, except where such action would also amount to a fraudulent conveyance.⁶⁷

⁶⁶ See, however, *In re Amdur Shoe Co.*, 13 Fed. (2d) 147 (D. Mass. 1926); *State v. Bank of Hemingford*, 58 Neb. 818, 80 N. W. 50 (1899); and dicta in *Ashbury Railway Carriage & Iron Co. v. Riche*, *supra* note 5, at 667, 691. In *Perkins v. Trinity Realty Co.*, 69 N. J. Eq. 723, 721, 61 Atl. 167, 170 (1905) it is said: "Without attempting to formulate a definition, I think it may be properly said that the doctrine of *ultra vires* is that at the instance of the state where public policy requires it, or at the instance of stockholders or creditors whose rights would otherwise be injuriously affected, corporations will be held powerless to do anything not clearly within the terms of their charters or statutory provisions." The court states, however, that it was not shown that there were any creditors to be protected.

⁶⁷ *Force v. Age-Herald Co.*, 136 Ala. 271, 33 So. 866 (1902); *Bank of Berwick v. Vinson Shingle & Mfg. Co.*, 124 La. 1000, 50 So. 823 (1909);

In opposition to the alleged right are the following considerations:

(a) The right of the state and of the shareholders to object to ultra vires conduct is found in their contract contained in the articles of incorporation. A corresponding contract between the creditor and the corporation is found only by implication and is then based upon the assumption that the creditor knew and relied upon the charter limitations upon corporate authority. That, however, may be a false assumption. Persons dealing with a corporation may, without culpability, be unaware of the limitations upon corporate authority. The rule contended for would cause a distinction to be made between two equally innocent corporate creditors, based upon the fortuitous circumstance, subsequently developed, that the contract of the one was intra vires while that of the other was ultra vires.

(b) If the defense of ultra vires were based upon the desire to protect intra vires creditors, then the defense would be allowed only when the corporation was the party defendant, and when a judgment against it would result in depleting its assets. When the corporation was plaintiff, seeking by a recovery to swell its assets, it would not then be justifiable to permit the other party to succeed upon a plea of ultra vires. The New York court laid hold of this distinction in *Bath Gas Light Co. v. Claffy*,⁶⁸ where, referring to the English cases of *Ashbury Co. v. Riche*⁶⁹ and *Macgregor v. Dover & Deal Ry.*,⁷⁰ it said: "It is important to observe that in each of these cases the action was brought against the offending corporation . . . and that the effect of a recovery would have been to divert and appropriate the funds of the corporation by the actions of the courts, to unauthorized objects, to the prejudice of . . . stockholders and creditors." The action then before the New York court was for the purpose of reimbursing the corporation, and recovery was allowed. At present, however, the courts make no distinction between cases in which the corporation is plaintiff and in which it is defendant; the federal courts, for example, deny recovery upon the partially executed contract in either case,⁷¹

Gullege v. Woods, 108 Miss. 233, 66 So. 536 (1914). In *Washington Mill Co. v. Sprague Lumber Co.*, 19 Wash. 165, 52 Pac. 1067 (1898) the language of the court is broad enough to base the creditors' rights upon the fact that the transaction was ultra vires, but in fact the transaction was a fraudulent conveyance. Under the exploded trust fund theory, a creditor's right to relief might have been worked out.

⁶⁸ *Supra* note 53, at 32, 45 N. E. at 392.

⁶⁹ *Supra* note 5.

⁷⁰ 18 Ad. & E. 618 (Ex. Ch. 1852).

⁷¹ In *Central Transportation Co. v. Pullman's Car Co.*, *supra* note 6, the lease sued upon was ultra vires the plaintiff corporation; while the contract could not be the foundation of an action, the plaintiff was allowed a

and the New York courts permit recovery in both cases to the extent that the plaintiff has performed.⁷²

(c) It would not seem expedient to establish a rule which would permit an intra vires creditor, whatever the size of his claim, to exercise a superintendency over corporate affairs. It was said in an English case,⁷³ after finding no precedent for an injunction against ultra vires action at the suit of a creditor: "It would be a fearful authority for this Court to assume, for it would be called on to interfere with the concerns of almost every company in the kingdom against which a creditor might suppose that he had demands, which he had not established in a court of justice, but which he was about to proceed to establish." Sufficient protection of the public interest against the usurpation of authority by a corporation would seem to exist in the right of the state to institute a *quo warranto* proceeding and the right of the shareholder to enjoin, without conferring a similar power of superintendency upon creditors. It would seem clear, therefore, that the ultra vires doctrine is not in reality governed by a consideration for the rights of intra vires creditors. The decisions certainly cannot be explained on any such ground.⁷⁴ It would seem also that no corrective legislation is needed with respect to this phase of the ultra vires problem, but that in the interest of clarity the restatement might definitely negative the creditor's right to injunctive relief against ultra vires transactions.⁷⁵

4. *Is it beyond the capacity of a corporation to do an ultra vires act?*

Further argument in support of a negative answer to this question seems now to be superfluous; it would necessitate a repetition of reasoning already advanced. The negative answer was most effectively stated by Mr. George Wharton Pepper in 1898.⁷⁶ The fundamental theses of this article are: (a) that

quasi-contractual recovery. The federal rule which permits a quasi-contractual recovery against a corporation ignores the interests of intra vires creditors.

⁷² In *Bath Gas Light Co. v. Claffy*, *supra* note 53, the corporation was plaintiff, whereas in *Parish v. Wheeler*, 22 N. Y. 494 (1860) the corporation was defendant, but in each case the plaintiff recovered upon an ultra vires contract.

⁷³ *Mills v. Northern Ry.*, L. R. 5 Ch. App. 621, 623 (1870).

⁷⁴ Upon the rights of intra vires creditors in general see: 3 FLETCHER, *op. cit. supra* note 17, at § 1529; 14A C. J. 336; 4 COOK, *op. cit. supra* note 31, at § 735; 3 THOMPSON, CORPORATIONS (2d ed. 1908) § 2850; 2 MORAWETZ, *op. cit. supra* note 24, at §§ 782, 783, 797-799; Warren, *op. cit. supra* note 38, at 541; Carpenter, *op. cit. supra* note 44, at 65.

⁷⁵ But see the provision in the proposed Canadian uniform corporation act, *infra* note 89.

⁷⁶ *Rights under Unauthorized Corporate Contracts* (1898) 8 YALE LAW JOURNAL, 24.

it should be recognized that a group of individuals though incorporated can do an unauthorized, or even an illegal, act, and (b) that the problem of the courts is to determine what legal consequences should be attributed to such acts. The only essential difference between articles of incorporation and articles of partnership is that the former evidences a contract between the members and the state as well as a contract between the members *inter sese*. In dealing with unincorporated associations, we have the problem of protecting only the members against a violation of their contract, but in dealing with incorporated associations, we have, in addition, the problem of establishing a sufficient deterrent against the violation of the state's contract with the members. It has already been suggested that the judicial process by which decisions are reached, even in federal and minority state courts, is not one of logical deduction from the premise of limited corporate capacity, but is one of seeking the solution which will best serve the public interests.⁷⁷ The Supreme Court itself has said in *Salt Lake City v. Hollister*,⁷⁸ "the argument is unsound that whatever is done by a corporation in excess of the corporate powers, as defined by its charter, is as though it was not done at all." Should an unsound argument continue to be advanced as a reason for a decision? The conception of a corporate entity is rational enough, and it is a conception that has its useful applications. But this spectre of a fictitious entity, invisible and intangible, should not be permitted to haunt and control us some two centuries after witchcraft.⁷⁹ Still, this artificial personality, notwithstanding its physical impotence, continues to exist in contemplation with sufficient cogency at times to dictate decisions. We have ceased to be impressed by the reasoning that a corporation has not been endowed with the capacity to commit a tort or a crime. Under

⁷⁷ *Supra* pp. 312-15.

⁷⁸ *Supra* note 19, at 260, 6 Sup. Ct. at 1058.

⁷⁹ Machen, *Corporate Personality* (1911) 24 HARV. L. REV. 253, 347, at 260: "All that the law can do is to recognize, or refuse to recognize, the existence of this entity. The law can no more create such an entity than it can create a house out of a collection of loose bricks. . . . Hence, it follows that in recognizing the existence of a corporation as an entity, the law is merely recognizing an objective fact, while in refusing to recognize fully the existence of a partnership or voluntary association as an entity the law is shutting its eyes to facts. Therefore, what needs explanation in the common law is not the doctrine that a corporation is an entity, but the doctrine that a partnership or other voluntary association is not an entity."

Warren, *op. cit.* *supra* note 28, at 496: "Corporate action unsanctioned by the sovereign is as real as corporate action sanctioned by the sovereign. Unauthorized corporate action is as real as authorized corporate action. The question becomes: Is it ever proper for the judges to act upon the fiction in the absence of a direction from the sovereign,—is it ever proper for the judges to give legal validity to unauthorized corporate action?"

the doctrine of *respondeat superior*, we hold it responsible for torts of its agents, even malicious torts,⁸⁰ and permit the recovery of punitive damages against it,⁸¹ and we make it criminally responsible for the acts of its agents.⁸² According to the majority view, it may be held responsible for torts committed by its agents while engaged in an ultra vires undertaking,⁸³ and there is every reason why it should be criminally responsible for acts of its agents done while they, under its authority, are engaged in an ultra vires venture.⁸⁴ Why should not the corporation be held for any ultra vires contracts made for it by its agents, acting

⁸⁰ *Dorsey Machine Co. v. McCaffrey*, 139 Ind. 545, 38 N. E. 203 (1894) (malicious prosecution); *Reed v. Home Savings Bank*, 120 Mass. 443 (1879) (malicious prosecution); *Hoboken Printing & Publishing Co. v. Kahn*, 59 N. J. L. 218, 35 Atl. 1053 (1896) (libel); *Kharas v. Barron Collier, Inc.*, 171 App. Div. 388, 157 N. Y. Supp. 410 (1916) (slander); *O'Brien v. Bates Corp.*, 211 App. Div. 743, 208 N. Y. Supp. 110 (1925) (libel); *Houston Printing Co. v. Jones*, 282 S. W. 854 (Tex. 1926) (libel); authorities collected 7 R. C. L. 683, n. 8.

⁸¹ *Kennelly v. Kansas City Ry.*, 214 S. W. 237 (Mo. App. 1919); (1919) 33 HARV. L. REV. 111; *Corrigan v. Bobbs-Merrill Co.*, 223 N. Y. 53, 126 N. E. 260 (1920); (1920) 5 CORN. L. Q. 303; (1910) 9 MICH. L. REV. 337.

⁸² *State v. Lehigh Valley R. R.*, 90 N. J. L. 372, 103 Atl. 685 (1917), *aff'd* 92 N. J. L. 261, 106 Atl. 23 (1919), *aff'd* 94 N. J. L. 171, 111 Atl. 257 (1920) (manslaughter); (1920) 19 MICH. L. REV. 205; (1920) 5 MINN. L. REV. 74; (1920) 30 YALE LAW JOURNAL, 415; Francis, *Criminal Responsibility of the Corporation* (1924) 18 ILL. L. REV. 305. In *United States v. MacAndrews & Forbes Co.*, 149 Fed. 823, 836 (C. C. N. Y. 1907) an indictment under the Sherman Law, Judge Hough says: "It seems to me as easy and logical to ascribe to a corporation an evil mind as it is to impute to it a sense of contractual obligation. There is an obvious physical difficulty in rendering a corporation amenable to corporate punishment, but there is no more intellectual difficulty in considering it capable of homicide or larceny than in thinking of it as devising a plan to obtain usurious interest. . . . The same law that creates the corporation may create the crime, and to assert that the Legislature cannot punish its own creature because it cannot make a creature capable of violating the law does not, in my opinion, bear discussion." In *United States v. Nearing*, 252 Fed. 223, 231 (S. D. N. Y. 1918) a conspiracy to incite insubordination in the army, Judge Learned Hand said: "Finally, the defendants urge that a corporation cannot be guilty of the crime of conspiracy, or of any crime involving specific intent. This question simply turns upon how far the law has gone in imputing to a corporation the acts of its agents. . . . It is a question upon which the law has always tended toward larger and larger liability. . . . Now, there is no distinction in essence between civil and criminal liability of corporations, based upon the element of intent or wrongful purpose. Each is merely an imputation to the corporation of the mental condition of its agent. . . . That the criminal liability of a corporation is to be determined by the kinship of the act to the powers of the officials, who commit it is true enough, but neither the doctrine of *ultra vires*, nor the difficulty of imputing intent or motive, should be regarded any longer to determine the result."

⁸³ *Supra* at 301.

⁸⁴ *Union Colliery Co. v. Queen*, *supra* note 24, dictum.

within the scope of the authority conferred upon them; and correspondingly, why should not the corporation obtain the benefit of the rights incident to such contracts?

The fallacious conception that a corporation has capacities limited to those conferred upon it by statute and by its charter ought to be removed from legal fictions. The conception has its source, not in the inherent nature of a corporation, but in the interpretation of legislative will. A common law corporation has unlimited capacity; a legislatively created corporation can have unlimited capacity. It is submitted that the legislative limitation cannot be upon corporate capacity, but may be upon corporate authority. This distinction was made by the Vermont legislature in 1915 when it adopted a revised corporation act which refers to corporate "authority" rather than corporate "powers."⁸⁵

The need for solving the *ultra vires* problem has held the attention of Canadian lawyers since the decision in the *Bonanza Creek* case in 1916,⁸⁶ and the method of solution has been the subject of discussion in the meetings of the Canadian Bar Association. In 1916, that body adopted the following resolution: "That the Committee in charge be instructed to prepare a draft Act for submission at the next meeting of the Association, which will recognize the principles of the doctrine of *ultra vires* as suggested by Mr. Robson's paper."⁸⁷ In 1919, the same body adopted a resolution looking in the other direction, and, in effect, abolishing the conception of limited capacity, and in particular abolishing the defense of *ultra vires* in contract actions.⁸⁸ The draft presented by the committee in 1922 is printed in the footnote.⁸⁹ No Uniform Corporation Act, however, has as yet been approved by the Canadian body.

The following provision is suggested for inclusion in a Uniform Corporation Act to be submitted to the National Conference of Commissioners on Uniform State Laws:

⁸⁵ *Supra* notes 3 and 13.

⁸⁶ *Supra* note 9.

⁸⁷ (1916) 2 PROCEEDINGS CAN. BAR ASS'N, 19, 185.

⁸⁸ (1919) 4 *ibid.* 38-47. See also (1918) 3 *ibid.* 71-74, 205.

⁸⁹ (1922) 7 *ibid.* 382: "15A. Every company heretofore or hereafter created, (a) By or under this Act, or by or under any Act for which this Act was substituted; or (b) By or under any Act hereafter passed in substitution or in lieu of this Act; or (c) By or under any general or special Act of the legislature of the province of, shall, unless otherwise expressly declared in the Act or instrument creating it, or in the memorandum of association thereof, have, and be deemed to have had from its creation, . . . the general capacity which the common law ordinarily attaches to corporations incorporated by royal charter under the great seal. . . .

"15B. Any contract made by a company shall, as between the con-

I. A corporation which has been formed under this Act, or a corporation of a class which might be formed under this Act, shall have the capacity to act possessed by an unincorporated association of natural persons.

II. The authority of such a corporation to act shall be limited to the performance of those acts which are necessary or proper for the accomplishment of its purposes and which are not repugnant to law.

The first paragraph, recognizing the fact that a corporation can do an unauthorized, prohibited or criminal act, extends the application of the section to corporations of a general business character formed before this provision became law, but negatives its application to corporations formed under particular laws, such as insurance, banking and public service corporations. There may be no reason why corporations of the latter type should not be accorded similar treatment, but this is beyond the scope of a uniform general corporation act, and should be accomplished by modelling those special laws.

The phrase "an unincorporated association of natural persons" is used rather than the phrase "a natural person," as a legislative recognition of the capacity of the incorporated association for group action. The two paragraphs together are intended to make clear the legislature's intention to limit the "authority" of a corporation and not its "capacity."

5. Is a corporation allowed the defense of ultra vires in a contract action for the reason that the party dealing with it was charged with notice of the legal limits upon corporate authority?

It is frequently found stated in the opinions that there is an obligation upon anyone contracting with a corporation to take notice of the charter limitations upon its authority, and that,

tracting parties and all persons lawfully claiming any right thereunder, be binding upon the parties thereto, notwithstanding that such contract was beyond the powers of the company, and in any action brought in any Court of this Province, upon or in respect of any such contract, no person shall plead that the contract was beyond the powers of the company.

"Provided, however, that the Court shall have power at the suit of any shareholder or creditor of a company, to enjoin the company or its directors or officers from engaging in or attempting to engage in any business or transaction which is outside the scope of the objects or powers of the company,

"And provided, further, that any director or officer of the company who authorizes or consents to the company engaging in any business or transaction which is outside the scope of the objects or powers of the company, shall be personally liable for any damages sustained by the company at the suit of the company or any shareholder on behalf of himself and all other shareholders. . . ."

Section 15B has been criticized on the ground that it does not protect the corporation against a third party who was aware that the contract was ultra vires. Gurd, *The Ideal Company Law* (1924) 2 CAN. BAR. REV. 485, 488.

therefore, such person has no standing to hold a corporation to a contract, of the ultra vires nature of which he was bound to know.⁹⁰ In fact, however, decisions are entirely at variance with the conclusions that would logically result from the adoption of the premise. A holding that a corporation is responsible for an ultra vires tort can be reconciled with a holding that it is not responsible for an ultra vires contract, upon the theory that only the plaintiff in the contract action is charged with notice of the extent of corporate authority. But the application of the same theory would produce inconsistency between a decision that a corporation is not responsible for a wholly executory contract, and a decision that it is responsible for a contract that the plaintiff has performed. Can the plaintiff's performance eradicate the taint of the guilt with which he was chargeable before performance? Under the theory of constructive notice, a decision that a plaintiff, who has fully performed an ultra vires contract, cannot recover against the corporation upon that contract (the minority view), could not be reconciled with a decision that the same plaintiff may, however, recover against the corporate agents upon an implied warranty of authority.⁹¹ He cannot claim deception as to a fact concerning which he had notice. Similarly, the application of that theory would make it unreasonable to hold that a plaintiff could estop the corporation from pleading ultra vires because it had misled him as to the extent of its authority.⁹² Accordingly, we find that the courts which at one time assert that one who deals with a corporation is bound to know the charter limitations upon its authority, do at other times render decisions in utter disregard of that principle. As a conclusion, we may say that when

⁹⁰ *McCormick v. Market Bank*, 61 Ill. App. 33 (1895), *aff'd* 162 Ill. 100, 44 N. E. 381 (1896), *aff'd* 165 U. S. 538, 17 Sup. Ct. 433 (1897); *Carpenter*, *op. cit. supra* note 44, at 61.

⁹¹ In *Sanford v. McArthur*, 57 Ky. 411 (1857) it was held that the agent was not liable upon an implied warranty because the plaintiff was charged with notice of the extent of corporate authority. But in *Seeberger v. McCormick*, 178 Ill. 404, 53 N. E. 340 (1899), writ of error dismissed, 175 U. S. 274, 20 Sup. Ct. 128 (1899) the corporate agent was held upon an implied warranty although in previous litigation the same plaintiff was denied recovery against the corporation upon the contract, and limited to quasi-contractual recovery, the Supreme Court assigning as one reason for its decision the fact that the plaintiff was charged with notice of the corporate lack of authority. *McCormick v. Market Bank*, *supra* note 90.

⁹² *Steele v. Fraternal Tribunes*, 215 Ill. 190, 74 N. E. 121 (1905) where the representatives of an insured, who had performed, were denied recovery upon an ultra vires contract, the court saying that there could be no estoppel for the insured could not claim ignorance as to corporate powers. *Acc: Mercantile Trust Co. v. Kastor*, 273 Ill. 332, 112 N. E. 988 (1916); *Geraghty v. Washtenaw Fire Ins. Co.*, 145 Mich. 635, 640, 108 N. W. 1102, 1104 (1906).

a decision is to be made against the plaintiff who has dealt with the corporation, he is "charged with constructive notice" of the ultra vires nature of the transaction; but when it seems fair that judgment should be in his favor, the defendant is not allowed to play the constructive notice trump against him. Constructive notice may be used to sustain a decision, but it does not cause one. We must look for some other guiding principle.

The application of the principle of constructive notice has been held to be unjust where the person dealing with the corporation could not reasonably be expected to make inquiry; "a traveller from New York to the Mississippi can hardly be required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations."⁹³ Its application has been held to be unjust where the question of ultra vires is dependent upon a possible construction of an ambiguity in a statute or the articles of incorporation.⁹⁴ It has recently been held that at the most, the rule works only against those who deal directly with the corporation, and not against one, for example, who takes a corporate note by indorsement from a third party, knowing that it was issued in payment of the corporation's ultra vires subscription for shares in another corporation.⁹⁵

The application of the doctrine of constructive notice cannot be supported by analogy to the principle in criminal law that "everyone is presumed to know the law," or that "ignorance of the law is no excuse," for ultra vires action is not criminal action.⁹⁶ It is believed that the doctrine has found its way into corporation law partly through the medium of this false analogy, and partly through an inferred legislative intention. As to the latter, there is no similarity of purpose between recording acts and the statutory requirement that articles of incorporation be filed for record. The very scheme of recording acts makes it essential to charge the public with notice of the matters recorded. On the other hand, the purpose of requiring articles of incorpo-

⁹³ *Bissell v. Michigan Southern R. R.*, *supra* note 13, at 231.

⁹⁴ *Denver Fire Ins. Co. v. McClelland*, 9 Colo. 11, 9 Pac. 771 (1885).

⁹⁵ *City Coal & Ice Co. v. Union Trust Co.*, *supra* note 38: (1925) 10 CORN. L. Q. 498. Corporation A executed its note to corporation B in payment of A's subscription to stock in B. B indorsed the note to plaintiff who sues A. Plaintiff knew that stock in B was the consideration A received for the note. *Held*, that this information put plaintiff "under no duty to make further inquiry, and the technical rule of conclusive notice from the charter applies only to parties dealing directly with a corporation or its officers." *City Coal & Ice Co. v. Union Trust Co.*, *supra* note 38, at 608-609, 125 S. E. at 699.

⁹⁶ *Supra* at 309. If the transaction is not merely ultra vires, but unlawful or prohibited as well, then the application of the constructive notice theory is appropriate. *Jarski v. Farmers' & Merchants' Bank*, 206 N. W. 773 (N. D. 1925) (contract found to be both ultra vires and unlawful).

ration to be filed or recorded is no different than the purpose of requiring the articles of association of a limited partnership or joint stock company to be filed or recorded. That purpose, it is submitted, is not to charge the public with notice of the contents of the paper filed, but to afford the public the opportunity to ascertain the contents thereof. No case has been found where a person dealing with such an unincorporated association, whose articles have been filed in compliance with the statute, has been denied relief on the ground that he was charged with notice of the contents of such articles.⁹⁷ The rights of such a person are governed solely by the rules of Agency. Unless the contract is one that is illegal or prohibited by statute, the state has no more substantial concern whether it is the contract of a corporation or the contract of an unincorporated association. If, on the other hand, the contract is one the making of which is illegal or prohibited, then the state is as much concerned when it is the contract of such an unincorporated association as when it is the contract of a corporation.⁹⁸

If the principle of constructive notice is not one that really influences courts' decisions with respect to ultra vires contracts, what principle should guide them? It is believed that the answer is that it can be, and should be, that same principle which obligates a third party to ascertain the authority of an agent in the law of Agency. It was said by the Massachusetts court:

"There is a clear distinction, as was pointed out by Mr. Justice Campbell in *Zabriskie v. Cleveland, Columbus & Cincinnati Railroad*, 23 How. 381, 398, by Mr. Justice Hoar in *Monument Bank v. Globe Works*, 101 Mass. 57, 58, and by Lord Chancellor Cairns and Lord Hatherly in *Ashbury Railway Carriage & Iron Co. v. Riche*, L. R. 7 H. L. 668, 684, between the exercise by a corpora-

⁹⁷ The Uniform Limited Partnership Law, § 2, requires that there be filed for record a certificate stating, among other things, the character of the business to be carried on.

The General Associations Law of New York, Consol. Laws (Cahill, 1923) c. 20, § 4, does not require that the certificate, which must be filed for record by every joint stock company, shall state the character of the business to be carried on, but the partnership association laws of Michigan and Pennsylvania do require it. 2 Mich. Comp. Laws (1915) § 7950; 2 Pa. Digest (Purdon's 13th ed. 1905) 2023, 5 *ibid.* (Supp. 1916) 6483.

The declaration of trust of a business trust must be filed in Massachusetts. 2 Mass. Gen. Laws (1921) c. 182. The same was true in Oklahoma. 2 Okla. Comp. Stat. Ann. (1921) § 8466; repealed by 1 Okla. Comp. Stat. Ann. (1926) § 4194-1.

⁹⁸ In *Howell v. Earp*, 21 Hun, 393 (N. Y. 1880) the plaintiff, a creditor of defendant E, sought to set aside a conveyance made by E to the defendant joint stock company. A statute restricted the right of such an association to purchase and hold realty not needed for its immediate purposes. It was held that "if the statute is violated, it is the province of the State to see to its enforcement. Plaintiff is not entitled to break in and have conveyances declared void in this collateral mode."

tion of a power not conferred upon it, varying from the objects of its creation as declared in the law of its organization, of which all persons dealing with it are bound to take notice; and the abuse of a general power, or the failure to comply with prescribed formalities or regulations, in a particular instance, when such abuse or failure is not known to the other contracting party.”⁹⁹

That is, it is generally conceded that in those instances, at least, the party dealing with the corporation may show that he had reasonable ground to believe that the particular transaction was intra vires, and that he was not negligent in failing to ascertain that it was in fact ultra vires. In Arkansas, it has been held that a citizen of that state dealing with a foreign corporation entitled to do business in the state, was not guilty of negligence in failing to ascertain the charter limitations upon the corporation's authority, so as to give the corporation a defense in an action upon an ultra vires contract.¹⁰⁰ The Virginia court has recently said the same thing, in effect, in holding that though the indorsee of a corporate note knew that the corporate maker had executed and delivered the note in payment for its subscription for shares in another corporation, he was not negligent in failing to inquire whether the maker had authority to subscribe for and hold shares in another corporation.¹⁰¹

Is this not the true method of approach in determining the rights of persons voluntarily dealing with a corporation; an application of the same principle which determines the rights of a third party against the principal in the field of Agency? There is an obligation upon such persons to use reasonable precautions to ascertain the authority of the agents with whom they are dealing. To quote from Professor Mechem's work on Agency: "An assumption of authority to act as agent for another of itself challenges inquiry. Like a railroad crossing, it should be in itself a sign of danger and suggest the duty to 'stop, look and listen.'"¹⁰² That statement is as much applicable in the case of corporate agents as in the case of an individual or an unincorporated group of individuals. The apparent scope of the authority of a corporate agent may exceed the charter limits of its authority, either by the assent of the shareholders, express or implied, or by implication from the knowledge that the corporation has authority if certain facts exist or if certain formalities are complied with. In the *Monument National Bank* case,¹⁰³ the contract was actually ultra vires, but the question of corporate

⁹⁹ *Davis v. Old Colony R. R.*, *supra* note 43, at 260.

¹⁰⁰ *Minneapolis Fire Ins. Co. v. Norman*, 74 Ark. 190, 85 S. W. 229 (1905).

¹⁰¹ *Supra* note 38.

¹⁰² 1 MECHEM, AGENCY (2d ed. 1914) § 743.

¹⁰³ *Monument Nat'l Bank v. Globe Works*, 101 Mass. 57 (1869).

authority depended upon the existence of certain acts peculiarly within the knowledge of the corporate agents. The principle there applied is identical with that applied when a local freight agent, in direct violation of his instructions, issued a bill of lading before the goods had been delivered to him for shipment.¹⁰⁴

Though a principal may, upon diverse grounds, be responsible for the acts of an agent done in excess of the authority actually conferred upon the agent, one established limitation is that a third party who knew, or, as a reasonably prudent man, ought to have known that the agent was acting in excess of his authority may not hold the principal responsible. So any person dealing with corporate agents must exercise that diligence to ascertain the limits of the agent's authority which the ordinarily prudent man would exercise under similar circumstances. In principle it matters not whether the transaction is *intra vires* or *ultra vires*; whether the limitation upon the agent's authority is found in the charter or in the by-laws. But in fact, those differences are of vital importance. The conduct of the reasonably prudent man will depend largely upon the accessibility of the information concerning the extent of the authority; the law requiring the articles to be filed has made the information therein contained available for one who is geographically near to the places of filing.¹⁰⁵ By-laws, usually being corporate records, closed to outsiders, are treated as secret limitations upon the authority of corporate agents.

The point is forcefully illustrated by a recent development in the law of Pennsylvania. In *Putnam v. Ensign Oil Co.*,¹⁰⁶ one of the corporation's defenses to a suit upon its promissory note was that the note was signed by the treasurer and secretary, instead of by the president and secretary as required by the company's by-laws. The court said:

"Pennsylvania has adhered to the rule that the by-laws of a corporation are written into the charter, defining and limiting the rights, duties and powers of its officers, and places persons dealing with the corporation on notice as to the extent of the officers' power and agency . . . The reason for the Pennsylvania rule is a desire to protect stockholders in every possible way against mismanagement of corporate business; but the

¹⁰⁴ *Armour v. Michigan R. R.*, 65 N. Y. 111 (1875); *Bank of Batavia v. New York, L. E. & W. R. R.*, 106 N. Y. 195, 12 N. E. 433 (1887); *MECHEM*, *op. cit. supra* note 102, §§ 757-62.

¹⁰⁵ *Warren*, *op. cit. supra* note 38, at 540: "It is submitted that the courts should not require persons contracting with corporations to ascertain at their peril the contemplated scope of corporate action, unless the nature of the corporation and the contract make such requirement reasonable. (The subsidiary facts being found, the ultimate question whether, on such facts, such a requirement is reasonable should be for the court to determine.)"

¹⁰⁶ 272 Pa. 301, 307-9, 116 Atl. 285, 287 (1922).

proposition is no doubt sound that the business world, constituting by far the greater number of persons interested in the security and integrity of certain commercial acts, may be, and no doubt is, injuriously affected by the continuation of such rule. When our rule was adopted corporations were not so numerous; at present they have taken hold of the vast majority of business enterprises of the country . . . The question becomes pertinent, Where an individual is held for acts of this agent, done within the apparent scope of authority, why should a group of individuals, as a corporation, stand in any different position?"

This decision in 1922 was approved by the court in 1923,¹⁰⁷ but the suggestion in the earlier case that there was need for legislative improvement of the law, produced the enactment of this provision in 1925:¹⁰⁸

"The by-laws of any corporation organized or doing business within the Commonwealth shall operate merely as regulations among members or stockholders of the corporation and shall have no effect upon contracts or other dealings with other persons unless such persons shall have actual knowledge of such by-laws."

As the public was entitled to be relieved from the effect of the former Pennsylvania rule of constructive notice of by-laws, so the public is entitled to be relieved from the effect of the rule, now more honored in the breach than in the observance, that it is charged with notice of the contents of the corporate charter. The corporate body is not entitled to the unqualified protection which that rule would give it; but is entitled to protection against persons, who in dealing with corporate agents, are culpably negligent and fail to ascertain that the transaction contemplated exceeds the authority conferred upon the agents. Nor do the interests of the public require the application of the rule. The interest which the public has in preventing the usurpation of authority by the corporation, fades beside the interest of the public that there shall be a feeling of security in dealing with corporations. The result of litigation evidences this.

Just as in Pennsylvania, constructive notice of by-laws became the rule because of a supposed legislative intent, and corrective legislation became necessary, so the doctrine of constructive notice of the contents of corporate charters also deserves to be

¹⁰⁷ *Millar v. Grieb & Thomas, Inc.*, 276 Pa. 372, 120 Atl. 330 (1923) (action upon an alleged contract for services).

¹⁰⁸ Pa. Laws 1925, No. 329, § 1. Only the first of the two sections of the act is quoted. See a similar provision in Georgia. 2 Ga. Ann. Code (Parks, 1915) § 2225. In *Dinsmore v. Nat'l Hardwood Co.*, 208 N. W. 701, at 702 (Mich. 1926) it was recently held that under the Michigan sale of securities act, "representations to the commission are not intended for the prospective purchaser [of shares], and, unless he knows and relies upon them when he purchases, it cannot be advanced that he was in any way influenced by them."

neutralized by the enactment of a legislative antidote. So far as that doctrine derives its vitality from a presumption of legislative intention, it will wither if the legislature gives expression to its actual intention. The rules of Agency would still be left free play, with the result that the third party who has entered into an ultra vires contract, would fail to recover only when it could be said that, as a reasonably prudent man, he should have acquired knowledge of the material facts as to corporate authority recorded, both for his benefit and for the protection of the shareholders.¹⁰⁹ That phase of the problem could be clarified in the restatement, but legislation is needed to remove a technical premise which the majority of American jurisdictions now ignore when justice so demands it. Such a statutory provision would not reform the law, but would make for consistency in the decisions of a given state, and for uniformity in the decisions of the courts of different states. Accordingly, the following provision is proposed for inclusion in a Uniform Corporation Act:

The filing of articles of incorporation, or amendments thereto, and of any other papers,¹¹⁰ pursuant to the provisions of this Act, is required for the purpose of affording all persons the opportunity of acquiring knowledge of the contents thereof, and not for the purpose of charging them with notice of the contents thereof.

6. *Is the defense of ultra vires required for the protection of the rights of shareholders?*

It would seem that there can be no doubt that the answer to this question must be in the affirmative. Besides being a contract between the state and the incorporators and their assigns, the charter is a contract between the associates themselves, limiting the purposes for which they have combined their capital and the character of the business to be carried on therewith.

Collateral attack upon the authority of a corporation to contract with outsiders is not needed for the protection of intra vires creditors; they have their remedies for fraudulent conveyances and for prohibited returns of capital to shareholders. If a contract is neither illegal nor prohibited, but only ultra vires, then it does not so offend the public interest that collateral attack is required. However, non-assenting shareholders are to be protected. But if all shareholders have assented to a given ultra

¹⁰⁹ See the interesting discussion in *Sturdevant v. Farmers' & Merchants' Bank*, 62 Neb. 472, 87 N. W. 156 (1901) and affirming opinion in 69 Neb. 220, 95 N. W. 819 (1903).

¹¹⁰ Corporation statutes require other statements, or affidavits, to be filed, *e. g.*, with regard to the allotment and payment of shares. Since the requirement of filing is in each instance for the same purpose, to make information available for the public, there is no reason for confining the statement of this purpose to the articles of incorporation and amendments thereto.

vires transaction, they are not entitled to the defense that the contract is ultra vires.

The fact that an act done on the behalf of a corporation is ultra vires gives rise to two questions: *first*, shall the act be given legal consequences as a corporate act unless all shareholders have assented; *second*, shall legal consequences be attributed to it as a corporate act even if all shareholders have assented to it? The solution of the first question is to be reached by applying the principles of the law of Agency; the solution to the second question has involved the additional application of certain principles peculiar to the law of Corporations: (a) the public policy against corporate usurpation of authority without the assent of the state; (b) the doctrine of limited capacity; and (c) the doctrine of constructive notice. The last two should be removed by statute; the first is more than neutralized by the public interest in the security of business transactions.

It is realized that a "corporate act" is a fiction in the same sense that it is fictitious to speak of the act of an agent as the act of his principal. Yet the fiction is a convenient symbol of the process of reasoning by which we reach the result that the corporation ought to be held responsible for, or given the advantage of the act of another.¹¹¹ When incorporated associates procure an act to be done for them by another, or ratify an act that has been done on their behalf, the act is no less a corporate act because it is done ultra vires. As partners can make an act done outside the business agreed upon in the articles of partnership their act, so incorporated associates can act in excess of the authority conferred in the articles of incorporation. The aptness of the analogy was emphasized by Chief Judge Comstock in the *Bissell* case.¹¹²

A corporation is not responsible for its agent's acts done by him while acting in excess of the apparent scope of the authority conferred upon him. An ultra vires act is not only in excess of

¹¹¹ Holmes, *Agency* (1891) 4 HARV. L. REV. 345, 351: "The fiction is merely a convenient way of expressing rules which were arrived at on other grounds. . . . But when such a formula is adopted, it soon acquires an independent standing of its own. Instead of remaining only a short way of saying that when from policy the law makes a master responsible for his servant, or because of his power gives him the benefit of his slave's possession or contract, it treats him *to that extent* as the tort-feasor, possessor, or contractee, the formula becomes a reason in itself for making the master answerable and for giving him rights." See also 2 MORAWETZ, *op. cit. supra*, note 24, at § 732.

¹¹² *Supra* note 13, at 263-4: It is untrue to say that "these artificial existences are cast in so perfect a mould, that transgression and wrong become impossible . . . like natural persons, they can overleap the legal and moral restraints imposed upon them: in other words, they are capable of doing wrong." *Ibid.* at 270-1: "Now, in a well-regulated unincorporated partnership, the articles entered into by the associates specify

the authority conferred by the state upon the corporation, but is primarily in excess of the authority conferred by the corporation upon its agent.¹¹³ It is submitted that the legal effect of acts done on behalf of a corporation should be determined according to the principles of the law of Agency; and that, in this respect, there is no substantial difference in the principles to be applied whether the principal for whom certain persons, called directors, have acted was a joint stock company or a corporation.¹¹⁴ As the corporation may authorize an act *intra vires* but beyond the usual scope of directors' authority, so the corporation may authorize or ratify an act which is *ultra vires* and, therefore, primarily beyond the scope of the directors' authority.¹¹⁵

What constitutes corporate ratification? The true answer has been given by Morawetz:

"Ratification by a corporation of an act in excess of its charter,

the object of their association. But, suppose the same associates desire a charter of incorporation for the more convenient prosecution of the same business, and obtain one. We shall find it to contain the like specification, which becomes the grant of power from the sovereign authority of the state. . . . The charter takes the place of the articles of agreement, and becomes the appropriate rule of action. No public interest or policy is involved, because the objects of the grant are not of a public nature; the powers and rights specified are identical with those which any private person or association of persons may exercise. If those who manage the concerns of a simple partnership deal with the funds in a manner or for purposes not specified, their acts are *ultra vires*; and if the directors of such a corporation as I am here speaking of, do the same thing, their acts are also *ultra vires* in the same sense and no other."

¹¹³ Richard Hanlon Millinery Co. v. Miss. Valley Trust Co., 251 Mo. 553, 570, 158 S. W. 359, 361 (1913): "The defense of *ultra vires* is, therefore, bottomed upon a wise public policy to protect the stockholders (the real body of the corporation) from the acts of their own agents, where such agents clearly do acts or make contracts beyond the charter powers and rights of the corporation." But the court based its decision upon the doctrines of limited capacity and constructive notice.

¹¹⁴ In Rianhard v. Hovey, 13 Ohio, 200, 302-3 (1844) it is said with regard to the *ultra vires* acts of the directors of a joint stock company: "First: That as to all creditors who have dealt with the directors and agents of the association in good faith, without a knowledge of their departure from the original objects of the association, that all stockholders are liable upon the principle of copartnership liability. . . . Fourth: That all those who have dealt, knowingly, with the directors and agents of the company, in matters not coming within the scope and objects of the associates, have no claim to call upon any of the stockholders, save those who were cognizant of the manner in which the agents and directors were conducting, and by their silence or direct action assented to and ratified their acts. It is a wholesome rule that should be applied in a case like this—that where a member of a copartnership, whose agents are daily exceeding their authority, stands by and makes no objection at the proper time, he will be considered as agreeing to the acts of the agent, and will not be listened to in equity when it becomes his interest to assert the contrary."

¹¹⁵ When an *ultra vires* transaction has been assented to by all share-

means ratification by the entire body of shareholders; no agent of a corporation has authority to ratify an act which he had not original authority to do"¹¹⁶ . . . "If the shareholders, who constitute the corporate association, unanimously acquiesce in or ratify an act performed by an agent or board on behalf of the corporation, no further question as to the extent of the powers delegated to the agent or board can arise. Ratification by all the shareholders would not cure the *illegality* of an act which is prohibited by the common law or by statute; but it would remove any defect of authority in the agent performing the act, as between himself and the company. After such ratification, the company would become chargeable with the act to the same extent as if it had originally authorized it to be done."¹¹⁷

Some may shrink from the thought that corporate ratification of an ultra vires act involves the unanimous assent of the shareholders. However, the principles of the law of Agency take care of the situation, and while the principles apply equally to corporate and natural principals, the facts upon which ratification may be predicated may differ. It is common knowledge that in large corporations a substantial proportion of the shareholders may not be interested in, and may even be apathetic toward the management of corporate affairs. Under such circumstances, either a ratification might be based upon a silent acquiescence, or proof of an intention not to ratify might be excluded because of laches. If shareholders are negligently inattentive to corporate affairs, the scope of the authority delegated by them may be held to be extended by reason of such negligence.¹¹⁸ To quote from two leading works on Agency: "The scope of an agency is to be determined not alone from what the principal may have told the agent to do, but from what he knows, or in the exercise of ordinary care and prudence ought to know, the agent is doing in the transaction." "¹¹⁹ "Where a principal conducts his affairs

holders, the corporation cannot succeed on the defense of ultra vires. *Lincoln Court Realty Co. v. Kentucky Title Co.*, 169 Ky. 340, 185 S. W. 156 (1916); *Perkins v. Trinity Realty Co.*, *supra* note 66.

¹¹⁶ 2 MORAWETZ, *op. cit. supra* note 24, at § 581.

¹¹⁷ 2 *ibid.* § 623.

¹¹⁸ MORAWETZ, *op. cit. supra* note 24, at §§ 618-639. *Denver Fire Ins. Co. v. McClelland*, *supra* note 94, at 25, 9 Pac. at 779: ". . . we think, on principle and the weight of modern decisions, that if the stockholders, whose business it is to see that their own managing officers act within the proper scope of their powers, either expressly or by silence impliedly, assents to acts done on their behalf in excess of authority, they should be held estopped to deny that such acts were authorized." See, in addition, *In re Amdur Shoe Co.*, *supra* note 66 (ratification of accommodation indorsement based on silent acquiescence of all shareholders with knowledge); *Olson v. Warroad Mercantile Co.*, 136 Minn. 310, 161 N. W. 713 (1917); *Bissell v. Michigan R. R.*, *supra* note 13, at 275. See dicta in *Citizens Bank v. Valdosta Mill & Elevator Co.*, 34 Ga. App. 713, 131 S. E. 126 (1925); *Black Hawk Bank v. Monarch Co.*, 207 N. W. 121 (Iowa, 1926).

¹¹⁹ 1 MECHEM, *op. cit. supra* note 102, at § 755.

so negligently as to lead third persons to reasonably suppose that his agent has full powers, then, if the agent exceeds his authority, the principal must bear the loss."¹²⁰

The explanation commonly advanced by state courts for holding a corporation upon a partially executed contract is that a plaintiff who has fully performed his part of the contract may "estop" the corporation from pleading *ultra vires* as a defense.¹²¹ It is submitted that this is an erroneous use of the term "estoppel,"¹²² and that the corporation should be bound only when the conduct in accepting the benefits amounts to a ratification, or is such that the corporation is guilty of laches in not repudiating. As for the third party, he is not held upon the principle of estoppel; he has not misled the corporation as to the extent of its own authority. Though the contract was normally one beyond the scope of the authority of corporate agents, the third party will be bound either because in the particular instance it was authorized by the body of shareholders or ratified by them, if not by any previous act, then by the act of beginning suit.¹²³

The variety of the circumstances from which ratification, estoppel, negligence or laches may be inferred is so infinite that it would be unwise to attempt to formulate a statutory rule to control decisions upon this aspect of the *ultra vires* problem. The principles now exist in the common law and are being satisfactorily applied to cases of *ultra vires* corporate action. A third party dealing with a corporate agent, who is acting within the

¹²⁰ WHARTON, COMMENTARY ON AGENCY (1876) § 123.

¹²¹ *Denver Fire Ins. Co. v. McClelland*, *supra* note 94; *Schlitz Brewing Co. v. Poultry & Game Co.*, 287 Mo. 400, 229 S. W. 813 (1921) where the estoppel was allowed notwithstanding Mo. Rev. Stat. (1919) § 9749 and § 169—art. 12 of the Constitution—which says that "no corporation shall engage in business other than that expressly authorized in its charter or the law under which it may have been or may hereafter be organized. . . ." *Chafin v. Main Island Co.*, 85 W. Va. 459, 463, 102 S. E. 291, 293 (1920). *Cf. Hind v. Cook & Co.*, *supra* note 47 (no estoppel because the contract was expressly prohibited). The authorities are collected in 3 FLETCHER, *op. cit. supra* note 17, at § 1547 *et seq.* Courts adhering to the theory of limited capacity hold that there can be no estoppel. See the authorities collected in 14A C. J. 323, n. 97. And no ratification by the corporation. 14A C. J. 316, n. 59. But see *Welsh v. Bruce Sewing Machine Co.*, 223 Ill. App. 467 (1921), certiorari denied 226 Ill. App. XXXVIII (1923).

¹²² *Harris v. Independence Gas Co.*, *supra* note 38.

¹²³ *Olson v. Warroad Mercantile Co.*, *supra* note 118, places the decision both upon estoppel and authorization. BIGELOW, *op. cit. supra* note 23, at 501-504, adhering to the view that a corporation lacks capacity to do an *ultra vires* act, asserts that while a corporation may not be estopped from denying its capacity, the third party may be estopped, since "a man cannot set up the incapacity of the third party with whom he has contracted in bar of an action by that party for breach of the contract. Legal disability generally, as *e. g.*, in the case of an infant, is a defense personal to him who is under it, and cannot be made use of by another."

apparent scope of his authority, should be able to recover against the corporation even though the particular contract be ultra vires; but a third party who negligently fails to ascertain that the agent is acting both beyond the scope of his authority and the scope of corporate authority, should not be permitted to recover against a non-assenting corporate principal. If a corporate body has authorized or ratified an ultra vires contract, neither it nor the third party should be permitted to attack the corporation's authority to make the contract. The restatement of the law of Agency may be expected to furnish what revision seems necessary, and the pertinent provisions of such restatement could be made applicable to corporations by including them in the restatement of the law of Business Corporations.

It may be urged by some that we should go to a further extreme by establishing it as law that all acts of the board of directors shall be considered corporate acts, even though ultra vires. The justification for this would be that in practice shareholders, especially in large corporations, do not interest themselves in corporate activities and consequently ought not be permitted to upset a transaction by establishing their ignorance of it as proof that they had not assented to it. The Vermont statute seems to go this far.¹²⁴ But instead of establishing this rule by statute, is it not better to leave the question dependent upon the flexibility of the rules of Agency? The very method of shareholders' participation in the affairs of a large corporation furnishes the facts upon which to predicate authorization or ratification by negligence, or laches and perhaps estoppel. Justice is reached by applying these principles to the facts. On the other hand, if the corporation is a private family affair, or one of moderate size, shareholders who can establish their alert attention to corporate affairs, ought to be able to disavow ultra vires transactions, if they have not been negligent in ascertaining the

¹²⁴ Vt. Laws 1915, No. 141, § 15: "If any act is done in behalf of a corporation, and such act is authorized or ratified by the directors or trustees, or such act is done within the scope of authority given by the directors or trustees, such act shall (provided that a corporation with authority to do such an act might at the time such act was done have been formed under the laws of this state) be regarded as the act of the corporation and the corporation shall be liable therefor, even if such act was not necessary or proper to accomplish its purposes, to the same extent that it would have been liable for such act if the act had been necessary or proper to accomplish its purposes." If the directors act *intra vires*, but in excess of the apparent scope of the authority conferred upon them, the corporation will not be liable. Does it follow from the last clause of the above provision that, therefore, the corporation will not be liable if the ultra vires act of the directors was beyond the scope of the authority conferred upon them by the corporation? If not, is it just that directors should have a greater power to bind the corporation in ultra vires matters than in *intra vires* matters?

facts and acting upon them when discovered. We grant this much to shareholders with respect to transactions which are *intra vires* but done in excess of the authority conferred by them upon the directors. Is it just, then, to deny them the right to repudiate acts which have been done entirely beyond the scope of corporate purposes?

CONCLUSION

It is to be remembered that the foregoing discussion is based upon these two assumptions: (a) that an *ultra vires* act is merely one that a corporation is unauthorized to do by its charter and by the statutes which regulate it—the expression does not apply to an act which is prohibited or one that is illegal; (b) that the recommendations made are intended here to be confined in their application to corporations formable under general business corporation laws, though it is believed that the same recommendations might properly be applied to the classes of corporations formable under special statutes, such as banking, insurance and public service corporations.

With those limitations in mind, it is submitted that the adoption of the recommendations here made would produce but one change in the results now reached by courts in the great majority of American jurisdictions. The one change would result from the fact that no distinction is here made between contracts which are still wholly executory and other contracts. It is arguable that the rule that executory *ultra vires* contracts are not enforceable operates to discourage the making of *ultra vires* contracts. Perhaps it would in those instances where both parties are aware that a contemplated contract will be *ultra vires*, but its application works injustice where the fact of *ultra vires* is not present to the consciousness of either party and where that fact is later used by one of them as a last ditch of defense. In the latter case, the ethical position of the parties is no worse than when the contract has been partially or fully performed. The hardship upon the plaintiff in not being able to recover damages is no less when he has not performed than when he has. While the contract should be the foundation for an action for damages, we should rely upon the discretion of a court of equity to grant or withhold specific performance as the justice of the particular case seems to demand.¹²⁵ The principles of Agency apply to contracts whether they are executory or executed, so that a third party, negligent in failing to ascertain the directors' breach of authority, could not recover against non-assenting shareholders, but a third party could recover against

¹²⁵ Cf. *Case v. Kelly*, 133 U. S. 21, 10 Sup. Ct. 216 (1890); *Mutual Life Ins. Co. v. Stephens*, 214 N. Y. 488, 108 N. E. 856 (1915); *Fayette Land Co. v. L. & N. R. R.*, 93 Va. 274, 24 S. E. 1016 (1896).

the corporation upon a showing of authorization, ratification or laches on the part of the body of shareholders.

No legislation is needed to give the state a right to institute a *quo warranto* proceeding, a shareholder the right to enjoin, or the corporation the right to recover from its agents such damage as it may sustain in consequence of ultra vires transactions undertaken by them. No legislation is needed with regard to the responsibility of a corporation for a tort committed in an ultra vires transaction, with regard to the validity of a title taken by a corporation in excess of its authority, or to the rights acquired under an ultra vires contract fully performed. The proposed recommendations will not unsettle the law with respect to these questions, but rather will reinforce the existing decisions and give them a more rational foundation. A restatement would set forth these rules which are so well established.

The narrow field of existing conflict is limited to cases arising out of partially executed contracts. Of the six grounds advanced in support of permitting collateral attack upon corporate authority in this field, it has been shown that authority and reason are opposed to permitting collateral attack in the interests of intra vires creditors, that unauthorized corporate action is not to be regarded as illegal corporate action, and that the public policy in favor of honesty and a feeling of security in dealing with corporations is thrown in the balance against the public policy against corporate incursions into unauthorized fields. Two of the other grounds, the doctrine of constructive notice and the doctrine of limited capacity, would be eliminated by the proposed legislation. The final ground for collateral attack, that the defense of ultra vires is required for the protection of the body of shareholders, means only that we have the problem of determining when an act done by corporate agents shall be considered a "corporate act," notwithstanding that the act is one which the corporation is unauthorized to do. The determination of that problem depends upon the application of principles familiar to the law of Agency.

The abolition of the doctrine of limited capacity and the abolition of the doctrine of constructive notice should come through legislative enactment. Further legislation than this upon the ultra vires problem would seem to be unnecessary. A codification of the residue might be attempted, but in codification lurks the danger of omission. The legislation which has been proposed would remove the two sources of greatest confusion, the chief obstacles to uniformity in decisions. The application of the principles of Agency, estoppel and laches to the facts of a particular ultra vires transaction ought to be set forth in a restatement of the law of Business Corporations; the rigidity of legislative rules and fixed classifications should be avoided.